DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER 99-0293

GROSS INCOME TAX FOR THE PERIOD COVERING THE FISCAL YEARS ENDING SEPTEMBER 30, 1993, 1994 AND 1995 (4TH QUARTER 1992--3RD QUARTER 1995)

NOTICE: Under IC § 4-22-7-7, this document is required to be published in the *Indiana Register* and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the *Indiana Register*. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Gross Income Tax—Imposition on Domiciliary—Source State of Gross Income—Installment Contract Interest

Tax Procedure—Protests—Burden of Proof

Authority: IC § 6-8.1-1-5-1(b) (1998); IC §§ 6-2.1-1-2, -1-16(28) and -2-2(a) (1988) (1993)(repealed 2003); IC § 6-8.1-1-3 (1988) (1993); *Okla. Tax Comm'n v. Chickasaw Nation*, 115 S.Ct. 2214 (U.S. 1995); *New York ex rel. Cohn v. Graves,* 57 S.Ct. 466 (U.S. 1937); *Wheeling Steel Corp. v. Fox,* 56 S.Ct. 773 (U.S. 1936); *Lawrence v. State Tax Comm'n of Miss.,* 52 S.Ct. 556 (U.S. 1932); *State v. Huffman*, 643 N.E.2d 899 (Ind. 1994); *Miles v. Dep't of Treasury,* 199 N.E. 372 (Ind. 1935) ("*Miles II*"); *Miami Coal Co. v. Fox,* 176 N.E. 11 (Ind. 1931); *Bethlehem Steel Corp. v. Ind. Dep't of State Revenue,* 597 N.E.2d 1327 (Ind. Tax Ct. 1992) ("*Bethlehem Steel I*"), *aff'd* 639 N.E.2d 264 (Ind. 1994) ("*Bethlehem Steel II*"); *Associated Ins. Cos. v. Ind. Dep't of State Revenue,* 655 N.E.2d 1271 (Ind. Tax Ct. 1995); 45 IAC §§ 1-1-7, -51 (1992) (repealed 1999); Judith A. Frank, *Preneed Funeral Plans: The Case for Uniformity*, 4 ELDER L.J. 1 (1996)

The protesting affiliated group (hereinafter "the protestant"), as second successor in interest to the taxpayer, argues that certain interest income the taxpayer received from pre-need funeral installment contracts should be excluded from gross income. The protestant alleges that the interest was from out-of-state business situses.

II. Gross Income Tax—Imposition on Domiciliary—Source State of Gross Income—"Pre-Need" Trust Interest and Dividend Distributions

Authority: 42 U.S.C.A. §§ 1381-1383(d) (West 1991 & Supp. 1995); FLA. STAT. ANN. § 497.415(1) (West 1988 & Supp. 1995); IC §§ 6-2.1-1-2, -16(28), and -2-2(a) (1988) (1993) (repealed 2003); IC §§ 6-8.1-1-3, -5-1(b) (1998); MICH. COMP. LAWS ANN. § 328.222(1) (West 1992); *Guar. Trust Co. v. Virginia,* 59 S.Ct. 1 (U.S. 1938); *New York ex rel. Cohn v. Graves,* 57 S.Ct. 466 (U.S. 1937); *Maguire v. Trefry,* 40 S.Ct. 417 (U.S. 1920); *Hunt v. Rousmanier's Adm'rs,* 5 L.Ed. 589 (U.S. 1823); *Whidden v. Sunny South Packing Co.,* 162 So. 503 (Fla. 1935); *Hawley v. Smith*, 45 Ind. 183 (1873); *Ind. Family & Soc. Servs. Admin. v. Culley,* 769 N.E.2d 680 (Ind. Ct. App. 2002); *Bethlehem Steel Corp. v. Ind. Dep't of State Revenue,* 597 N.E.2d 1327 (Ind. Tax Ct. 1992) ("*Bethlehem Steel I*"), *aff'd* 639 N.E.2d 264 (Ind. 1994) ("*Bethlehem Steel II*"); 45 IAC § 1-1-51 (1992) (repealed 1999); RESTATEMENT (SECOND) OF TRUSTS § 130(a) (1959); 90 C.J.S. *Trusts* § 240 (2002); Judith A. Frank, *Preneed Funeral Plans: The Case for Uniformity*, 4 ELDER L.J. 1 (1996)

The protestant contends that the Department should exclude from the taxpayer's gross income interest and dividends distributed to it from pre-need funeral trusts that receive deposits of, and invest, pre-need installment contract payments. The protestant submits that the interest and dividends should be excluded because the trusts are maintained and managed outside Indiana.

III. Gross Income Tax—Definition of "Gross Income"—Amortization of Intangibles—Pre-Need Trusts

Gross Income Tax—Definition of "Gross Income"—Amortization of Intangibles—Situses of Intangibles

Authority: I.R.C. (26 U.S.C.) § 167(a) (1988 & Supp. V 1993) (1994); IC §§ 6-2.1-1-2(a), -10, -11(1988) (1993) (repealed 2003); *Newark Morning Ledger Co. v. United States*, 113 S.Ct. 1670 (U.S. 1993); *INDOPCO, Inc. v. Comm'r,* 112 S.Ct. 1039 (U.S. 1992); *Davis v. United States,* 110 S.Ct. 2014 (U.S. 1990); *Buchanan v. Warley*, 38 S. Ct. 16 (U.S. 1917); *Dep't of Ins. v. Motors Ins. Corp.,* 138 N.E.2d 157 (Ind. 1956); *Ind. Dep't of State Revenue v. Colpaert Realty Corp.*, 109 N.E.2d 415 (Ind. 1952); *Dep't of Fin. Insts. v. Holt,* 108 N.E.2d 629 (Ind. 1952); *Dep't of Fin. Insts. v. Gen. Fin. Corp.*, 86 N.E.2d 444 (Ind. 1949); *Gardner-White Co. v. Dunckel*, 295 N.W. 624 (Mich. 1941)

The protestant argues that the Department should exclude from the taxpayer's gross income certain federal income tax deductions it took to amortize the pre-need trusts associated with two Texas mortuaries it acquired and later merged into itself. The protestant contends that the pre-need trust amortization deductions are not gross income, or in the alternative that if they are gross income, then they arise from out-of-state business situses.

IV. Gross Income Tax—Imposition on Domiciliary—Source State of Gross Income—(Insurance Commissions)(Fiscal Year Ending 09/30/1993)

Authority: I.R.C. (26 U.S.C.) § 1361(b)(1)(B) (1988) (1994)IC §§ 6-2.1-1-2, -16(28), -2-2(a) and –5-5(a) (1988) (1993) (repealed 2003); IC §§ 6-8.1-1-3, -5-1(b) (1998); 11A KY. REV. STAT. ANN. §§ 304.9-270(1) and 304.9-425 (Michie 1996 & 2001 Repls.); OHIO REV. CODE ANN. §§ 3905.18(A), 3905.181 [sic; should read "3905.18.1"] and 3905.20(B)(1). (Anderson 1996 & 2002 Repls.); *Ariz. Ins. Guar. Ass'n v. Humphrey*, 508 P.2d 1146 (Ariz. 1973); *Miami Coal Co. v. Fox,* 176 N.E. 11 (Ind. 1931); *Sample v. Kinser Ins. Agency, Inc.*, 700 N.E.2d 802 (Ind. Ct. App. 1998); *Vector Eng'g & Mfg. Corp. v. Pequet*, 431 N.E.2d 503 (Ind. Ct. App. 1982); *Bethlehem Steel Corp. v. Ind. Dep't of State Revenue,* 597 N.E.2d 1327 (Ind. Tax Ct. 1992) ("*Bethlehem Steel I*"), *aff'd* 639 N.E.2d 264 (Ind. 1994) ("*Bethlehem Steel II*"); *Bishop v. Am. States Life Ins. Co.*, 635 S.W.2d 313 (Ky. 1982); *Boro Hall Agency, Inc. v. Citron*, 329 N.Y.S.2d 269 (N.Y. Civ. Ct. 1972); *Hartford Fire Ins. Co. v. Whitman*, 79 N.E. 459 (Ohio 1906); *Cockrell v. Grimes*, 740 P.2d 746 (Okla. Ct. App. 1987); 45 IAC §§ 1-1-49(5) and -51 (1992) (repealed 1999); 43 AM.JUR.2D *Insurance* §§ 146 and 147 (2003); 2A C.J.S. *Agency* § 334 (2003); 44 C.J.S. *Insurance* §§ 201 and 205 (1993); 13 ERIC MILLS HOLMES, HOLMES' APPLEMAN ON INSURANCE 2D: LAW OF INSURANCE AGENTS §§ 95.1, 97.2 and 97.8 (LEXIS Publ'g 1999); Judith A. Frank, *Preneed Funeral Plans: The Case for Uniformity*, 4 ELDER L.J. 1 (1996)

The protestant submits that certain alleged insurance commissions paid by an insurance subsidiary of the taxpayer to two Kentucky and Ohio companies should be excluded from gross income because they were earned by out-of-state business situses.

V. Gross Income Tax—Imposition on Domiciliary—Receipt of Gross Income by Insurer as Agent (Insurance Commissions)(Fiscal Year Ending 09/30/1993)

Authority: IC §§ 6-2.1-1-2(a) and (b), -10, -11, -13 and -2-2 (1988) (1993) (repealed 2003); IC § 27-1-18-2(b) (1988) (1993); *Oil Supply Co. v. Hires Parts Serv., Inc.,* 726 N.E.2d 246 (Ind. 2000); *Derloshon v. City of Ft. Wayne Dep't of Redev.,* 234 N.E.2d 269 (Ind. 1968); *W. Adj. and Insp. Co. v. Gross Income Tax Div.,* 142 N.E.2d 630 (Ind. 1957); *Dep't of Treasury v. Ice Serv., Inc.,* 41 N.E.2d 201 (Ind.1942); *United Artists Theatre Circ., Inc. v. Ind. Dep't of State Revenue,* 459 N.E.2d 754 (Ind. Ct. App. 1984); *Rotation Prods. Corp. v. Dep't of State Revenue*, 690 N.E.2d 795 (Ind. Tax Ct. 1998); *Universal Group Ltd. v. Ind. Dep't of State Revenue,* 642 N.E.2d 553 (Ind. Tax Ct. 1994) ("*Universal Group III*"); 45 IAC §§ 1-1-8 to -10, -17, -51, -54 and -64 (1992) (repealed 1999)

In the alternative to its out-of-state-business-situs argument concerning the alleged insurance commissions, the protestant alleges that the taxpayer was not liable for gross income tax because the insurance subsidiary held the alleged commissions as agent for the Kentucky and Ohio companies.

VI. Gross Income Tax—Imposition on Domiciliary—Source State of Gross Income—Other Miscellaneous Gross Receipts From Out-of-State Business Situses

Authority: IC § 6-8.1-5-1(b) (1998)

The protestant contends that the taxpayer was not liable for gross income tax on certain miscellaneous gross receipts allegedly earned by business situses outside Indiana.

VII. Gross Income Tax—Imposition on Domiciliary—Source State of Gross Income—Miscellaneous Service Gross Receipts (Open/Close Trust Withdrawals) (Fiscal Year Ending 09/30/1993)

Authority: IC §§ 6-2.1-2-2(a)(1), -5(9), -7(b) and (c) (1988) (1993)(repealed 2003); IC § 6-8.1-5-1(b) (1998); *Okla. Tax Comm'n v. Chickasaw Nation*, 115 S.Ct. 2214 (U.S. 1995); *Guar. Trust Co. v. Virginia,* 59 S.Ct. 1 (U.S. 1938); *New York ex rel. Cohn v. Graves,* 57 S.Ct. 466 (U.S. 1937); *Wheeling Steel Corp. v. Fox,* 56 S.Ct. 773 (U.S. 1936); *Lawrence v. State Tax Comm'n of Miss.,* 52 S.Ct. 556 (U.S. 1932); *Maguire v. Trefry,* 40 S.Ct. 417 (U.S. 1920); *Ind. Dep't of State Revenue v. Bethlehem Steel Corp.,* 639 N.E.2d 264 (Ind. 1994) ("*Bethlehem Steel II*"), *aff'g* 597 N.E.2d 1327 (Ind. Tax Ct. 1992) ("*Bethlehem Steel I*"); *Indiana Department of State Revenue v. E.W. Bohren, Inc.*, 178 N.E.2d 438 (Ind. 1961); *Miles v. Dep't of Treasury,* 199 N.E. 372 (Ind. 1935) ("*Miles II*"); *Miami Coal Co. v. Fox,* 176 N.E. 11 (Ind. 1931); 45 IAC §§ 1-1-51, -112 (1992) (repealed 1999); RESTATEMENT (SECOND) OF TRUSTS § 130(a) (1959); 90 C.J.S. *Trusts* § 240 (2002)

The protestant submits that the taxpayer was not liable for gross income tax on certain pre-need trust principal withdrawals for grave-digging services performed at cemeteries it owned located outside Indiana.

VIII. Gross Income Tax—Deductions from Gross Income—Inter-Company Transactions

Authority: IC §§ 6-2.1-4-6, -5-5 (1988) (1993) (repealed 2003); 45 IAC §§ 1-1-166, -167 (1992)

The protestant argues that the taxpayer was entitled to deduct from gross income certain receipts the protestant alleges were the result of transactions between members of the taxpayer's Indiana affiliated group.

IX. Tax Administration—Amending Returns—Departmental Authority to Amend

Gross Income Tax—Imposition on Domiciliary—Source State of Gross Income—(Insurance Commissions)(Fiscal Year Ending 09/30/1994)

Gross Income Tax—Deductions from Gross Income—Bad Debt Deductions (All Years)

Authority: IC §§ 6-8.1-5-2(a), -6-3(a)(1), -10-3(a) (1993) (1998); *Middleton Motors, Inc. v. Ind. Dep't of State Revenue,* 380 N.E.2d 79 (Ind. 1978); 45 IAC §§ 15-5-7(d), -11-3 (1996) (2001)

The protestant requests the Department to amend the taxpayer's returns for the audit period to reflect gross income that the protestant alleges was included, and deductions that it alleges were omitted, in error.

X. Tax Administration—Negligence Penalty (Inter-Company Service Charges Adjustment)

Authority: IC § 6-8.1-10-2.1(e) (1998); 45 IAC § 15-11-2(c) (2001)

The protestant requests the Department to abate the negligence penalties imposed.

STATEMENT OF FACTS

The taxpayer was an affiliated group engaged in the mortuary and cemetery (including mausoleum) businesses in Indiana and several other states. It filed consolidated annual income tax returns at the federal level and for both Indiana gross and adjusted gross income tax purposes, using the accrual method of accounting and a fiscal year that ended on September 30. The Department conducted an income tax audit of the taxpayer for the fiscal years ending on September 30 of 1993, 1994 and 1995 (hereinafter "fiscal year 1993," "fiscal year 1994" and "fiscal year 1995," respectively) (collectively, "the audit period"). During those years the parent corporation (hereinafter "the parent") was incorporated and headquartered in Indiana. However, after the end of the audit period, the taxpayer was the subject of two mergers. It was first acquired by and merged into a Delaware corporation, which took the parent's name. It was this successor corporation with which the auditor dealt in conducting the audit. However, the acquiring corporation was thereafter in turn acquired by and merged into another corporation, chartered in a state other than Indiana or Delaware, and engaged in the same businesses as the taxpayer. Since it was this last corporation that filed the protest, the Department will refer to this second successor in interest as "the protestant" in this letter in order to distinguish it from the taxpayer.

The Department conducted a prior income tax audit of the taxpayer for fiscal years 1989 through 1991. In 1994 issued original and rehearing Letters of Findings in response to the taxpayer's protest of the proposed gross income tax assessments that arose out of that audit. At the hearing

on the present dispute and in a follow-up telephone conversation the protestant, through its attending employees, represented that during the audit period the taxpayer, with one exception, did not change its business practices from those it used in fiscal years 1989 through 1991. Accordingly, the Department finds that during the audit period the taxpayer centralized all the financial and administrative operations of the subsidiaries and of the parent's various locations at the parent's Indiana headquarters. The parent was responsible for paying all the subsidiaries' and locations' expenses. It made periodic automatic sweeps of the operating accounts of all of the parent's locations, and of those of all but two of the subsidiaries, transferring these revenues to the parent's checking account at an Indiana bank headquartered in the same city as the parent. The parent then paid the subsidiaries' payables out of those proceeds. In turn the subsidiaries, and the parent's various locations, were each responsible for reimbursing the parent for a part of the financial and administrative services it rendered to its locations and to the subsidiaries. The parent called these reimbursements "overhead allocations" in its chart of accounts.

The audit was for all types of Indiana income taxes, including under the former Gross Income Tax Act of 1933, chapter 50, 1933 Indiana Acts 388 (repealed 2003) and its implementing regulation, each formerly codified during the audit period, as amended, at IC article 6-2.1 (1988) (1993) and at 45 IAC article 1-1 (1992) (repealed and recodified 1999 as former 45 IAC article 1.1 (1996 and Supp. 1998) (repealed 2003)), respectively. The present protest involves only the parts of the proposed assessments that are for gross income tax. The Department will provide additional facts if and as needed.

SUMMARY OF FINDINGS

The Department denies the protest in part and sustains it in part. The Department denies the protest as to all issues except Issue III, as to which the protest is sustained.

I. Gross Income Tax—Exclusions From Definition of "Gross Income"—Interest and Dividend Gross Receipts From Out-of-State Business Situses

Tax Procedure—Protests—Burden of Proof
Gross Income Tax—Exclusions From Definition of "Gross Income"—Service Gross Receipts From Out-of-State Business Situses

DISCUSSION

A. OVERVIEW OF PRE-NEED FUNERAL CONTRACTS

The present issue and several others in this protest involve what the mortuary and cemetery industries call "pre-need" contracts and "pre-need" trusts. The discussion of these issues in the protest letter was at best conclusory and incomplete. In particular, the protestant's discussions in both that letter and its post-hearing memorandum on "pre-need trust amortization," the subject of Issue III, were confusing. Accordingly, the Department conducted its own research on these subjects. The Department therefore will discuss the taxpayer's specific activities during the audit

period concerning such trusts in the context of those industries' relevant general practices concerning "pre-need" sales, and the state regulatory schemes that govern "pre-need" trusts, as revealed by the Department's research.

One legal commentator has described "pre-need" contracts as follows:

> The concept of the preneed funeral contract has aptly been described as "pay now - die later." Typically, a consumer enters an agreement to presently pay for a package of funeral services and goods which will be delivered upon the death of a designated person. The consumer may prearrange his own funeral or arrange a funeral for another person.….
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> ….
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> With many preneed contracts, the consumer may customize fully his funeral by specifying the exact services to be provided as well as the specific goods to be used in conjunction with the funeral. Alternatively, the consumer can leave the details to his survivors.
>
> One option available with many preneed funeral contracts is the "guaranteed price" or "inflation proof" contract. An inflation proof contract establishes a fixed price for specified goods and services and requires that the funeral home provide these goods and services at the price established at contract execution. In effect, the consumer has locked in the price of the services and goods regardless of any inflation that may occur between contract execution and future delivery.

Judith A. Frank, *Preneed Funeral Plans: The Case for Uniformity*, 4 ELDER L.J. 1, 5-6 (1996) (footnotes omitted) (hereinafter Frank, *Preneed Funeral Plans*). The term "pre-need" was coined to describe such contracts, since the individual obviously pays for these items before they are needed. The prospective decedent's status with the mortuary or cemetery company changes from "pre-need" to "at-need" at death.

Although the consumer has the option to prepay in a lump sum, "pre-need payments are customarily made in…installments over a long period of time." JESSICA MITFORD, THE AMERICAN WAY OF DEATH REVISITED 87 (Alfred A. Knopf 1998) (hereinafter MITFORD, REVISITED). Pre-need contracts are thus a species of retail installment contract or conditional sales contract. *See* BLACK'S LAW DICTIONARY 324 (7th ed. 1999) (defining "retail installment contract"). Installment pre-need contracts, like all installment contracts, include a finance charge (i.e., interest) calculated on the declining balance of the amount financed or principal (i.e., the "guaranteed" or fixed price for the property and services selected).

B. THE PROPOSED ADJUSTMENT FOR PRE-NEED CONTRACT INTEREST AND THE PROTESTANT'S ARGUMENT

Parts of each of the Department's Notices of Proposed Assessment to the taxpayer were for gross income tax at high rate on five categories of interest the taxpayer received during the audit period. The protestant has challenged the proposed assessments as to three of these categories. The taxpayer described these categories on its federal Forms 1120 (U.S. Corporation Income Tax Return) for the audit period as "Merchandise Trust Interest," "Funeral Pre-need Trust Interest" (both discussed under Issue II below) and "Installment Contract Interest" (i.e., pre-need contract interest). As authority for the parts of the proposed assessments levied on the interest, the auditor applied, and found that the taxpayer satisfied, the "commercial domicile" test of former 45 IAC § 1-1-51 (1992) (repealed 1999)(last version at 45 IAC § 1.1-6-2 (2001) (repealed 2003)), the implementing regulation that specifically governed taxation of gross income from intangibles.

The protestant argues that the pre-need contract interest was not subject to imposition of gross income tax based on its factual representation that those contracts were sold at business locations outside Indiana. However, other than the respective locations of the parent and the subsidiaries, the protestant has not provided any facts to support this contention.

This omission is the first of several failures by the protestant to submit evidence, make argument, or cite to authorities to support its positions on the issues. In particular, the protestant has failed to prove enough facts to make its case, both as to the present issue and almost every other issue in this dispute. As to one of these other issues, specifically Issue V, the protestant has also failed to convince the Department that the protestant's legal position is sound.

C. INDIANA AUTHORITIES GOVERNING DETERMINATION OF THE GROSS INCOME TAX SITUS OF AN INTANGIBLE

1. Summary of the Implementing Regulation and Its Origins

Former 45 IAC § 1-1-51 applies to the present issue because, as noted above, pre-need contracts are a type of conditional sales contract, and the regulation's definition of "intangible" or "intangible property" specifically included conditional sales contracts. *Id.* The equitable interests in the various pre-need trusts forming the subjects of Issues II and III are also intangibles under the former regulation, as the Department will discuss under Issue II. So are the insurance agent licenses, agent registrations, agency contracts and insurance policies sold underlying the alleged commission income discussed under Issue IV. The definition includes, in addition to the categories specifically enumerated in former 45 IAC § 1-1-51, "*all* other evidences of similar rights capable of being transferred, acquired or sold." *Id* (emphasis added).

The former regulation is too long for the Department to quote even just the relevant parts in full in this letter. However, in *Indiana Department of State Revenue v. Bethlehem Steel Corp.,* 639 N.E.2d 264 (Ind. 1994) ("*Bethlehem Steel II*"), *aff'g* 597 N.E.2d 1327 (Ind. Tax Ct. 1992) ("*Bethlehem Steel I*"), the Indiana Supreme Court summarized this regulation as follows:

> **A. The Interpreting Regulation**. The Department's regulation, 45 I.A.C. 1-1-51, provides two tests for determining when intangible income derives from an Indiana activity, business, *or source*. First, *the "business situs" test* provides that if the taxpayer has established a business situs in Indiana, and "the intangible forms an integral part of a business regularly conducted at [that] situs," then the intangible has an Indiana situs for tax purposes. Second, *the "commercial domicile" test holds that if the taxpayer has established its commercial domicile in Indiana, then "all of the income from intangibles will be taxed . . . except that income which may be directly related to an integral part of a business regularly conducted at a 'business situs' outside Indiana."* If the taxpayer has established its commercial domicile in another state, then "no income from intangibles will be taxed . . . unless the taxpayer has also established a business situs in Indiana and the intangible income derived therefrom forms an integral part of that Indiana activity." *Id.*

Bethlehem Steel II, 639 N.E.2d at 268 (emphases added) (insertion by the court). However, "the Department did not construct its situs approach from whole cloth. The analysis was derived from the property tax context[.]" *Id.* Specifically, the regulation codified the "business situs" test of *Miami Coal Co. v. Fox,* 176 N.E. 11 (Ind. 1931), and the "commercial domicile" test of *Wheeling Steel Corp. v. Fox,* 56 S.Ct. 773 (U.S. 1936). *See generally Bethlehem Steel II*, 639 N.E.2d at 268-269 and *Bethlehem Steel I*, 597 N.E.2d at 1333-1334 (both discussing *Miami Coal* and *Wheeling Steel*). The "commercial domicile" test is the one the auditor used, and the "business situs" test as applied to intangibles acts as an exception to the "commercial domicile" test. The Department therefore will first discuss the "commercial domicile" test, and the effect of commercial domicile Indiana's power to tax income earned out of state.

2. Definition and Effect of "Commercial Domicile" on State Taxing Power Over Income Earned Out of State

A "commercial domicile" is "the actual seat of…corporate government." *Wheeling Steel*, 56 S.Ct. at 778. "The commercial domicile may also be called the 'nerve center' or 'corporate center of all the business functions of the taxpayer." Former 45 IAC § 1-1-51, fifth paragraph, last sentence. As its name implies, it is a type of domicile. " 'Domicil[e] implies a nexus between person and place of such permanence as to control the creation of legal relations and responsibilities of the utmost significance.' " *Ulrey v. Ulrey*, 106 N.E.2d 793, 795 (Ind. 1952), quoting *Williams v. North Carolina*, 65 S.Ct. 1092, 1095 (U.S. 1945). Among these responsibilities is that of paying taxes to the state in which one is domiciled. Domicile was one of the bases for imposing the gross income tax, both as a matter of explicit statutory language and of judicial construction. Former IC § 6-2.1-2-2(a)(1) imposed the gross income tax on "[t]he entire taxable gross income of a taxpayer who is a resident *or a domiciliary* of Indiana[.]" *Id* (emphasis added). In *Miles v. Department of Treasury,* 199 N.E. 372 ("*Miles II*"), *modifying on reh'g* 193 N.E. 855 (Ind. 1935), the Indiana Supreme Court, in upholding the gross income tax against both state and federal constitutional attacks, said:

> We conclude that the tax in question is an excise, *levied upon those domiciled within the state* or who derived income from sources within the state, *upon the basis of the privilege of domicile* or the privilege of transacting business within the state, and that the burden may reasonably be measured by the amount of income. The reasoning which justifies a tax upon the basis of domicile as readily supports and justifies a tax upon the basis of the right to receive income within, or transact business under the protection of, the state. We feel that the weight of reason and authority sustains this view.

Id. at 379 (emphases added).

Miles II also clearly recognized that the power to levy the gross income tax on Indiana domiciliaries included the power to levy it on income those domiciliaries earned outside the state. That opinion, *id.* at 378, quoted extensively from *Lawrence v. State Tax Commission of Mississippi,* 52 S.Ct. 556 (U.S. 1932), in which a Mississippi resident challenged that state's tax assessment on contracting income he earned in Tennessee. In sustaining the assessment the United States Supreme Court said:

> The obligation of one domiciled within a state to pay taxes there, arises from unilateral action of the state government in the exercise of the most plenary of sovereign powers, that to raise revenue to defray the expenses of government and to distribute its burdens equably among those who enjoy its benefits. Hence, *domicile in itself establishes a basis for taxation*. Enjoyment of the privileges of residence within the state, and the attendant right to invoke the protection of its laws, are inseparable from the responsibility for sharing the costs of government. *See Fidelity & Columbia Trust Co. v. Louisville*, 245 U.S. 54, 58[,] [38 S.Ct. 40, 40 (1917)]; *Maguire v. Trefry*, 253 U.S. 12, 14, 17[,] [40 S.Ct. 417, 418, 419 (1920)]; *Kirtland v. Hotchkiss*, 100 U.S. 491, 498[,] [25 L.Ed. 558, 562 (1879)]; *Shaffer v. Carter*, 252 U.S. 37, 50[, 40 S.Ct. 221, 224-225 (1920)]. The Federal Constitution imposes on the states no particular modes of taxation, and apart from the specific grant to the federal government of the exclusive power to levy certain limited classes of taxes and to regulate interstate and foreign commerce, *it leaves the states unrestricted in their power to tax those domiciled within them*, *so long as the tax imposed is* upon property within the state or *on privileges enjoyed there*, and is not so palpably arbitrary or unreasonable as to infringe the Fourteenth Amendment. *Kirtland v. Hotchkiss*, *supra*.
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> ….
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> It is enough, so far as the constitutional power of the state to levy it is concerned, that the tax is imposed by [that state] on its own citizens with reference to the receipt and enjoyment of income derived from the conduct of business, *regardless of the place where it is carried on*. *The tax,* which is apportioned to the ability of the taxpayer to bear it, *is founded upon the protection afforded to the recipient of the income* by the state, in his person, in *his right to*

> *receive the income*, and in his enjoyment of it when received. *These are rights and privileges incident to his domicile in the state* and to them the economic interest realized by the receipt of income or represented by the power to control it, bears a direct legal relationship.

52 S.Ct. at 557 (emphases and insertions added, and omission, by the Department).

Both the Indiana courts and the United States Supreme Court continue to take the position that the state can tax all of the income of its residents and domiciliaries. In *Thomas v. Indiana Department of State Revenue,* 675 N.E.2d 362 (Ind. Tax Ct. 1997), an individual Indiana adjusted gross (i.e., net) income taxpayer appealed this Department's denial of an a credit for income tax paid to, and assessed him tax on income earned in, the District of Columbia. On appeal, the taxpayer "challenge[d] Indiana's authority to levy the adjusted gross income tax on sources of income earned outside Indiana." *Id.* at 367. In response the Indiana Tax Court said:

> This claim is clearly without merit. It is well-established that a state "may tax *all* the income of its residents, even income earned outside the taxing jurisdiction." *Oklahoma Tax Comm'n v. Chickasaw Nation*, [515] U.S. [450], [462-463], 115 S.Ct. 2214, 2222, 132 L.Ed.2d 400 (1995)[emphasis in *Chickasaw Nation*]. In *New York ex rel. Cohn v. Graves*, the [United States] Supreme Court explained:
>
> > That the receipt of income by a resident of the territory of a taxing sovereignty is a taxable event is universally recognized. *Domicil itself affords a basis for such taxation*. Enjoyment of the privileges of residence in the state and the attendant right to invoke the protection of its laws are inseparable from the responsibility for sharing the costs of government. . . . A tax measured by the net income of residents is an equitable method of distributing the burdens of government among those who are privileged to enjoy its benefits. *The tax, which is apportioned to the ability of the taxpayer to pay it, is founded upon the protection afforded by the state to the recipient of the income in his person, in his right to receive the income and in his enjoyment of it when received. These are rights and privileges which attach to domicil within the state.* To them and to the equitable distribution of the tax burden, the economic advantage realized by the receipt of income and represented by the power to control it, bears a direct relationship.
> >
> > *Neither the privilege nor the burden is affected by the character of the source from which the income is derived.*

> 300 U.S. 308, 312-13, 57 S.Ct. 466, 467-68 (1937) (citations omitted [by the Indiana Tax Court]). That a state chooses to grant a credit to residents for taxes paid in other jurisdictions should not be mistaken for a lack of authority to levy on such proceeds. *See* 2 J. Hellerstein & W. Hellerstein, *State Taxation* § 20.04 (Supp. 1993). Thus, *this Court holds that Indiana has the authority to tax the out-of-state income of its residents.*

675 N.E.2d at 367-368 (all emphases after first added by the Department). The fact that the tax in issue here is gross rather than net, as was the case in *Cohn* and *Thomas*, and in *Chickasaw Nation* in relevant part, is a distinction without a difference. The type of income tax does not affect the fact that the state has the power to tax the income of its residents or domiciliaries, but only the extent to which it has chosen to exercise that power. *Miles II*, if no other opinion, remained dispositive authority that Indiana continued to have full power and authority to impose tax on the entire gross income of its domiciliaries, commercial or otherwise, wherever earned. Any abatement of that liability can only be in the form of an exclusion, exemption, deduction or credit, given as a matter of legislative, or authorized regulatory, grace. *See Thomas*, 675 N.E.2d at 368. Under IC § 6-8.1-5-1(b) (1998), the person against whom a proposed assessment is made has the burden of proving that it is wrong. This burden of proof includes proving entitlement to an exclusion, exemption, deduction or credit that the auditor disallowed.

The protestant admits that the commercial domicile of the parent was in Indiana. However, the parent's centralizing all the subsidiaries' financial and administrative operations at its Indiana headquarters indicates that Indiana was also in fact the headquarters, and thus the commercial domicile of not only the parent, but also of each member of the affiliated group and of the group as a whole. This was the case partly as a result of the group's own actions. The group chose to file consolidated Indiana gross income tax returns for the audit period. "The spirit and intent of the gross income tax consolidated filing statute [former IC § 6-2.1-5-5] is to treat an affiliated group as a single taxpayer." *Associated Ins. Cos. v. Ind. Dep't of State Revenue,* 655 N.E.2d 1271, 1274 (Ind. Tax Ct. 1995). By filing consolidated returns, the Indiana affiliated group thereby agreed to such treatment. Moreover, Indiana was the commercial domicile of that group not only in fact but also as a pure matter of law. The Indiana affiliated group is the taxpayer as a matter of substantive definition. *See* former IC § 6-2.1-1-16(28) and IC § 6-8.1-1-3 (1988) (1993) (1998) (respectively defining "taxpayer" and "person" as including, *inter alia*, any "group or combination acting as a unit[]") and former 45 IAC § 1-1-7 (defining a "taxpayer" as, *inter alia*, "a 'person' "). Legally, therefore, that group, not just the parent, was the taxpayer.

It follows from all of the foregoing facts and authorities that the commercial domicile of the parent is also the commercial domicile of the Indiana affiliated group, i.e. the taxpayer, and of each of its members. It further follows that Indiana, and this Department as the state agency authorized to administer the gross income tax, have full legal authority to assess that tax on all the gross income of the entire Indiana affiliated group unless the taxpayer proves that an exception, such as the "business situs" test discussed below, applies.

3. The "Business Situs" Test: Business Situs of a Taxpayer and Its Relationship to the "Commercial Domicile" Rule and to the "Tax Situs" of an Intangible

Former IC § 6-2.1-2-2(a)(1) imposed the gross income tax on "[t]he entire taxable gross income of a *taxpayer* [as previously defined, i.e. including an affiliated group] who is a resident *or a domiciliary* of Indiana[.]" *Id* (emphases added). Thus, both former IC § 6-2.1-2-2(a)(1) and former 45 IAC § 1-1-51 imposed gross income tax on all of the interest the taxpayer earned on its pre-need contracts as being, respectively, gross income in general and gross income from intangibles in particular, unless it can show that these contracts are *"directly related to an integral part of a business regularly conducted at a 'business situs' outside Indiana."* Former 45 IAC § 1-1-51, sixth paragraph, first sentence (emphasis added). The protestant thus has the burden of proving that the pre-need contracts fall within this exception to the "commercial domicile" test. The exception, like all "exceptions to a statute [or a regulation,] must be strictly construed." *Natural Res. Comm'n v. Porter County Drainage Bd.*, 576 N.E.2d 587, 589 (Ind. 1991). "The rules of statutory construction apply to the construction of administrative regulations[.]" *State Bd. of Tax Comm'rs v. Two Market Square Assocs., L.P.*, 679 N.E.2d 882, 885 (Ind. 1997).

The Tax Court explained the "business situs" test in *Bethlehem Steel I*, saying that

> the dispositive analysis for imposing tax under the "business situs" test focuses, as the [Indiana] supreme court did in *Miami Coal*, on the relationship between the intangible and the "business situs." A conclusion that an intangible is integrally connected with a taxpayer's "business situs" determines what may be termed the *intangible's "business situs"* or the *"tax situs" or "source"* of the intangible.

597 N.E.2d at 1334 (first emphasis in original) (second emphasis added). As the preceding quote indicates, the Tax Court created the phrase "tax situs," which the Indiana Supreme Court adopted on appeal (*see Bethlehem Steel II*, 639 N.E.2d at 269 and 270), as a synonym for an intangible's "business situs." In addition, *Bethlehem Steel I* refers to the "source" of an intangible as another synonym for its "business situs" (and, by extension, its tax situs). 597 N.E.2d at 1335. It does so because former IC § 6-2.1-2-2(a)(2) imposed the tax on the gross income of non-resident or non-domiciliary taxpayers "derived from activities or businesses or any other *sources* within Indiana[.]" *Id* (emphasis added). Many, if not most, of the reported Indiana opinions since *Miami Coal* that decided the "business situs" of an intangible, including the *Bethlehem Steel* opinions, did so under former IC § 6-2.1-2-2(a)(2) and its predecessors. However, the taxpayer in *Miami Coal* itself was an Indiana domiciliary corporation that the Indiana Supreme Court held had been improperly assessed property tax on accounts receivable the court found had an out-of-state business situs. The analysis for determining the business situs of an intangible under former 45 IAC § 1-1-51 is thus the same for resident or domiciliary taxpayers with out-of-state operations subject to former IC § 6-2.1-2-2(a)(1) and for non-resident or non-domiciliary taxpayers with in-state operations subject to former IC § 6-2.1-2-2(a)(2).

No single fact, such as the jurisdiction in which a business situs of a taxpayer is located, the physical location of an intangible, or the residence or domicile of the customer or buyer where the intangible in question is a contract, is conclusive in determining that intangible's tax situs. As a result of the *Bethlehem Steel* opinions, "we [now] look to the whole of the income-producing transaction—the actors, activity, and property—and weigh the in-state and out-of-state elements to determine if the intangible has an Indiana tax situs." *Bethlehem Steel II*, 639 N.E.2d at 269-270. "Deciding the source of income, or 'business situs,' [of an intangible] for purposes of state taxation,…is fact sensitive, requiring a case by case determination." *Bethlehem Steel I*, 597 N.E.2d at 1337. Making that determination, however, requires evidence of what those facts are, evidence that, as the Department will discuss below, the protestant has failed to provide.

D. THE PROTESTANT HAS FAILED TO SUSTAIN ITS BURDEN OF PROOF THAT THE PRE-NEED CONTRACTS HAD OUT-OF-STATE TAX SITUSES.

1. The Mortuary and Cemetery Industries Generally Market Pre-Need Contracts on a Centralized, Rather than a Local, Basis.

As previously noted, the protestant has not provided the Department with any evidence indicating the office through which each pre-need contract to be performed at an out-of-state location was sold. In particular, the protestant has provided no evidence indicating the office of the taxpayer through which each such pre-need contract was marketed, negotiated and brought into being, the office (if different) that decided to approve the contract and extend credit to each consumer, that kept the payment accounts and other records of executory contracts, and that supervised collection proceedings on delinquent contracts. The Department thus has none of the necessary facts before it from which it can make the fact-sensitive determination of the business situs of each pre-need contract to be performed at an out-of-state location.

The Department cannot simply presume from the mere circumstance that a pre-need contract was or is to be *performed* by an out-of-state subsidiary or location that it was also in fact *marketed and negotiated from, signed at and serviced from* that subsidiary or location. The latter circumstances do not necessarily follow from the former because of the existence of an alternative to local activity that the mortuary and cemetery industries generally use to market pre-need contracts. The best-known popular commentator on these industries describes this alternative marketing method as follows:

> All of the clever planning[,] [which the author had previously described,] to extract the maximum use from each acre of [cemetery] land would avail little if the cemetery promoter then had to sit back and wait upon the haphazard whim of the Grim Reaper. With the death rate at its present [1995-96] level, he might have to wait a very long time indeed to begin to realize profit on his investment. This barrier has been brilliantly surmounted by the massive "pre-need" sales campaign, *employing squads of telemarketers*…. One of the most successful devices in the history of merchandising, pre-need selling is the key to the runaway growth of the modern cemetery business.

MITFORD, REVISITED at 86 (emphasis added). *See also* JESSICA MITFORD, THE AMERICAN WAY OF DEATH 130 (Simon and Schuster 1963), which the above quotation repeats almost *verbatim*, but which instead refers to "squads of door-to-door salesmen[,]" *id.* The sales force might consist of employees of a mortuary or cemetery company, or could be a marketing company hired by that mortuary or cemetery company but acting as an independent contractor.

2. There Is Some Evidence From a Partly Overlapping Sales and Use Tax Audit of the Taxpayer Suggesting It Used a Centralized Sales Force to Market Pre-Need Contracts.

Thus, sales representatives that were operating out of, or controlled from, a location other than the out-of-state subsidiaries or locations at which the pre-need contracts were to be performed, may have contacted and solicited all or some of the consumers that entered into these contracts. In this connection the Department notes that the auditor included several completed copies of a form Prepaid Funeral Retail Installment Contract in the workpapers of a gross retail (sales) and use tax audit of the parent the auditor conducted simultaneously with the taxpayer's income tax audit, and that partly overlapped the income tax audit period. The contracts, most of which were executed in the third quarter of 1995 (i.e., within the income tax audit period), include a paragraph above the signature block in bold-faced type entitled "Purchaser's Right to Cancel." That paragraph repeats *verbatim* the statement of the buyer's right to cancel a home solicitation sale set out in Uniform Consumer Credit Code ("U.C.C.C.") § 2.503 (1968 Act), 7 U.L.A. Pt. III 285, 398-399 (2002), enacted by P.L. No. 366, § 3,1971 Ind. Acts 1557, 1605 and formerly codified at IC § 24-4.5-2-503 (1988) (repealed 1992). (IC § 24-4.5-2-502 (1988 and Supp. 1992) (1993), which incorporated the FTC Cooling-Off Rule, 16 C.F.R. Part 429 (1992-1994), performed the same function as the repealed statute during the audit period). The fact that the parent felt it necessary to use this paragraph, and continued to use it throughout the income tax audit period, implies that the parent was using a door-to-door or a telemarketing sales force. (P.L. 237, § 1, 1979 Ind. Acts 1132, amended IC § 24-4.5-2-501(1), the Indiana enactment of U.C.C.C. § 2.501(1), 7 U.L.A. Pt. III at 395, to define "home solicitation sale" as "including a solicitation over the telephone[.]" 1979 Ind. Acts at 1132).

3. The Protestant Has Not Submitted Any Evidence In this Protest Concerning the Pre-Need Contracts.

a. There Is No Evidence that the Taxpayer's Members Marketed the Pre-Need Contracts at Their Various Out-of-State Locations.

The protestant has submitted no evidence whatever in this protest concerning the pre-need contracts to be performed at the out-of-state subsidiaries or locations. It has by necessary implication therefore also failed to submit any evidence that any of the contracts were anything other than pre-need contracts the taxpayer solicited, as distinguished from pre-need or at-need contracts entered into by "walk-in" consumers at those locations. More importantly, the protestant has failed to submit any evidence that the taxpayer's members used sales forces that were operated and supervised from their respective out-of-state locations to market, negotiate and close these contracts. However, the Department wishes to make it clear that it is not finding that the taxpayer operated or controlled a centralized sales force from the parent's Indiana

headquarters. It is only finding that the protestant has failed to prove that the out-of-state subsidiaries and locations each had decentralized sales forces separate from any sales force that the parent's headquarters may have operated or controlled.

b. There Is No Evidence that the Out-of-State Subsidiaries and Locations Had Independent Authority to Accept Pre-Need Contracts.

The Department also cannot simply assume that the out-of-state subsidiaries and locations accepted each of the pre-need contracts on their own authority and without approval by the parent's Indiana headquarters. (*See* former 45 IAC § 1-1-49(5), which stated that one way of establishing a business situs, either in Indiana or another state, is "[a]cceptance of orders without the right of approval or rejection in another state[,]" *id.*) In this connection, it is important to remember that these are installment contracts and the decision to enter into one with a consumer is thus an extension of credit to that consumer. Typically, prior to extending credit, a prospective consumer creditor obtains a report on the prospective consumer to determine his or her creditworthiness. The creditor gets the report either from a national credit reporting company affiliated with, or directly from, a credit bureau located where the consumer resides, since the information the report will contain is at least in part a matter of local knowledge. However, the preparation of that report, which a third-party independent contractor performs, does not necessarily also imply that the decision to extend credit to the consumer is made by the prospective creditor's local outlet, rather than by its headquarters or an intermediate-level office. The Department is not finding that the parent's headquarters approved each of the pre-need contracts to be performed by an out-of-state subsidiary or location. However, as to any contracts it may have accepted, the intangible each such contract represented would have acquired an Indiana tax situs. This would be the case by operation of the "commercial domicile" rule as discussed above. However, in this connection it is also significant to note that the contract would be considered made in Indiana as a matter of consumer law, even if made with a non-resident consumer. IC §§ 24-4.5-1-201(1) and 1-201(1)(a), the Indiana versions of U.C.C.C. §§ 1.201(1) and 1.201(1)(a), 7 U.L.A. Pt. III at 315, respectively state that "this article applies to sales,…made in this state" and that "a sale…is made in this state if the buyer's agreement or offer to purchase…is received by the seller or a person acting on behalf of the seller in this state[]"). (The reference to "a person acting on behalf of the seller was added to IC § 24-4.5-1-201(1)(a) during the audit period by P.L. 122-1994, § 4, 1994 Ind. Acts 1473, 1476.) *See also* U.C.C.C. §§ 2.104(1) and 2.105(3), 7 U.L.A. Pt. III at 330 and 333, respectively codified at IC §§ 24-4.5-2-104(1) and -2-105(3), and which define "consumer credit sale" as including a "sale of…services," and "services" as "includ[ing] …(b) privileges with respect to… *funerals [and] cemetery accommodations*[.]" *Id* (emphasis added). The taxpayer, as an Indiana domiciliary, was chargeable with constructive knowledge of all of these legal authorities. It was thus doubly incumbent on the protestant to affirmatively establish that an out-of-state subsidiary or location, and not the parent's Indiana headquarters, made the final decision to accept each pre-need contract to be performed by that subsidiary or location. The protestant has failed to do so.

c. There Is No Evidence that the Out-of-State Subsidiaries and Locations Serviced Consumers' Payments on Executory Pre-Need Contracts.

Nor can the Department presume that the out-of-state subsidiaries or locations received and processed the payments on the pre-need contracts while these contracts were executory. As noted in the Statement of Facts, the parent centralized all the administrative and financial operations of the subsidiaries and of the parent's various locations at the parent's headquarters. All but two of the subsidiaries made daily wire transfers of their revenues to the parent's checking account at an Indiana bank headquartered in the same city as the parent. Logically, this financial centralization should have included, not just payments by new, "walk-in" pre-need or at need consumers, but also payments on already existing pre-need contracts. As noted earlier in this Discussion, "pre-need selling is the key to the runaway growth of the modern cemetery business." MITFORD, REVISITED at 86. Given this fact, the pre-need contract payments would have been too important a part of the taxpayer's cash flow for the parent not to have accounted for and managed them on the respective behalves of all of the taxpayer's members, including those with out-of-state operations. The Department is aware, as it will discuss under Issue II below, that most states require the deposit of pre-need contract payments into trusts specially created and maintained for that purpose. It is also aware that the taxpayer maintained at least one such trust in the name of each member of the taxpayer's Indiana affiliated group with out-of-state operations at a financial institution in that location's local market. However, these circumstances do not preclude the possibility that the taxpayer centralized the management and use of the pre-need contract payments. In this connection the Department notes that at the hearing the protestant submitted in evidence a Form 1041 (U.S. Income Tax Return for Estates and Trusts) for calendar year 1995 for a grantor trust the parent created, named for one of its out-of-state subsidiaries.

Aside from this fiduciary return, however, the protestant has not provided the Department with any evidence establishing how pre-need contract payments were treated, and in particular how they were routed and processed. The Department therefore cannot find that the consumers made their payments directly to the out-of-state subsidiaries or locations which then transferred the payments into their respective local pre-need trusts without any involvement of the parent's Indiana headquarters.

d. There Is No Evidence that the Out-of-State Subsidiaries and Locations Collected Delinquent Pre-Need Contract Balances.

Lastly, the protestant has submitted no evidence that each out-of-state subsidiary or location supervised the collection of delinquent contracts independent of the parent's Indiana headquarters. As far as the actual initiation of the collection process was concerned, Subparagraph 6(c) of the form Pre-Need Funeral Retail Installment Contract states that a "default [would be] referred to an attorney by SELLER[]" (emphasis in original), which on its face would appear to refer to the contracting member of the taxpayer. However, it does not follow from these circumstances that a contracting out-of-state subsidiary or location also in fact supervised the collecting firm subsequent to its being retained. In the absence of any evidence to this effect it is possible that the parent's headquarters could have done so, either directly through any collections personnel or in-house counsel it may have had, or indirectly through any debt

collection or law firm, it may have retained. Such supervision would have been consistent with the parent's centralization at its Indiana headquarters of the taxpayer's administrative and financial operations and payment of the members' expenses, including presumably any fees they incurred for professional collection services. It also would have been a logical extension of any accounting and management activities in which the parent engaged in connection with any contract payments it may have received on executory contracts not in default. The Department is not finding that the parent in fact engaged in such supervision, but only that the protestant has failed to prove that the out-of-state subsidiaries and locations did so.

4. The "Commercial Domicile" Test Therefore Applied and The Pre-Need Contract Interest Was Subject to Indiana Gross Income Tax.

In summary, the protestant has failed to submit any evidence to the Department from which it could determine the business situses of the pre-need contracts, which would not necessarily be same as the respective locations of the out-of-state subsidiaries and locations. The protestant has thus failed to meet its burdens of production of evidence , and of proof, that these intangibles had business situses outside Indiana and therefore fell within the "out-of-state business situs" exception to the "commercial domicile" test of former 45 IAC § 1-1-51, sixth paragraph. Having failed to bring the taxpayer within this exception, the "commercial domicile" test of that regulation is fully applicable to this issue. The proposed assessments of gross income tax on the interest that the pre-need contracts earned are fully consistent with this test as set out in former 45 IAC § 1-1-51 and the judicial opinions on which the regulation is based and which have interpreted it, as discussed above. The auditor, who used the "commercial domicile" test of the regulation as authority, therefore did not err in adjusting the taxpayer's gross income tax liability to propose these parts of the assessments.

However, even if the protestant had met its burden of proof that out-of-state tax situses had generated the interest, it would have been unavailing as to interest received by the parent from its direct outlets (as distinguished from any interest that subsidiaries incorporated and operating out of state may have received). Former IC § 6-2.1-1-2(c)(6) did state that as to Indiana-chartered corporations the definition of "gross income" excluded gross receipts "from a trade or business situated and regularly carried on at a legal situs outside Indiana or from activities incident to such trade or business…." *Id.* However, former IC § 6-2.1-1-2(d) qualified this exclusion in relevant part by stating that "[t]he exclusion provided by clause (6) of subsection (c) does not apply to any receipts of a taxpayer received as *interest or dividends*, from sales,…or to bonuses or commissions received by any taxpayer." *Id* (emphasis added). The auditor did not cite this latter statute as a basis for this adjustment, but the Department finds that it provides additional support for these parts of the proposed assessments as to any pre-need contract interest the parent received.

FINDING

The Department denies the protest as to this issue.

II. Gross Income Tax—Imposition on Domiciliary—Source State of Gross Income—"Pre-Need" Trust Interest and Dividend Distributions

DISCUSSION

A. THE PROPOSED ASSESSMENTS AND THE PROTESTANT'S ARGUMENT

The file indicates that each member of the group maintained one or more of what are called "pre-need trusts" in connection with the operations of each of that member's locations. All of these trusts had the same name as the member or location in question, and were described as being either "Funeral Pre-need Trusts" or "Merchandise Trusts." As noted in the Discussion of Issue I above, the Notices of Proposed Assessment to the taxpayer include proposed assessments of gross income tax at high rate on five categories of interest as depicted on the taxpayer's federal Forms 1120 filed during the audit period. In addition to the previously discussed category of "Installment Contract Interest," the protestant also challenges the proposed assessments as to the "Merchandise Trust Interest" and "Funeral Pre-need Trust Interest" categories. The Notices also include proposed assessments of gross income tax on dividends that the merchandise and funeral pre-need trusts earned during the audit period and distributed to the taxpayer, to which the protestant also objects. It argues that the interest and dividends distributed to the taxpayer's members were not subject to imposition of gross income tax on the ground that the trusts, and the trust securities that generated that income, were managed and maintained by trustees outside Indiana. Before addressing the merits of this argument, however, the Department will first discuss "pre-need" trust state regulatory schemes, both generally and in particular in states where the various members of the taxpayer's Indiana affiliated group were incorporated or maintained facilities. The Department will then examine how the terms of the taxpayer's pre-need contracts with its various customers relating to pre-need trusts and the income they earn fit within this statutory framework.

B. OVERVIEW OF STATUTORY REGULATION OF PRE-NEED FUNERAL TRUSTS

"The most common funding methods [for pre-need contracts] recognized under state statutes are (1) the state-regulated trust and (2) the funeral insurance or annuity policy." Frank, *Preneed Funeral Plans* at 7. (The Department discusses funeral insurance or annuity policies under Issue IV below.) "The most common form of funding for a preneed funeral contract…is the state-regulated trust." *Id.* Thirty-seven states "expressly require the creation of a trust account in connection with the sale of a preneed funeral contract." *Id* & n.27 (listing statutes from thirty-seven states that require creation of pre-need trusts, escrow or trust accounts, or equivalent forms of deposit). These states include Indiana, the parent's state of incorporation and commercial domicile, and Maryland, Michigan, Pennsylvania and West Virginia. *See id* (citing, *inter alia*, Indiana, Maryland, Michigan, Pennsylvania and West Virginia statutes). Another eight states make the use of a pre-need trust one valid option for the funding of a pre-need contract. *Id.* at 7 & n.28 (listing statutes from eight states that make pre-need trust optional). Among these are Florida, Illinois and Texas. *See id* (citing, *inter alia*, Florida, Illinois and Texas statutes). At least one member of the taxpayer's Indiana affiliated group had been incorporated or maintained an outlet in Florida, Illinois, Maryland, Michigan, Pennsylvania, Texas and West Virginia during the audit period.

Frank describes the basic method of administering pre-need funeral trusts as follows:

> In the simplest preneed funeral trust, the consumer pays the seller the agreed consideration for the future funeral services and goods. The seller in turn deposits the funds into a special account. Over the life of the agreement, the trust funds grow. Upon the death of the recipient, the provider performs the funeral. After giving proof of performance to the trustee, the provider seeks reimbursement out of the trust funds.

Frank, *Preneed Funeral Plans* at 22. Statutes in states that have mandated or authorized pre-need trusts also require the contracting mortuary or cemetery company to deposit into such trusts a percentage of the consumer's payments under the pre-need contract that varies from state to state. *See generally id.* at 26-27 & 26 nn.143-147 (respectively noting variance and classifying statutes specifying required percentages of deposit). "[T]he majority of states require preneed funeral sales proceeds to remain in trust accruing interest[.]" *Id.* at 28 & n.160 (citing, *inter alia,* Florida, Indiana, Michigan, Ohio, Texas, Virginia and West Virginia statutes). "The vast majority of states require that preneed funeral contract sale proceeds be entrusted to a fiscal institution as trustee or placed directly into some other financial depository." *Id.* at 23 & n.130 (citing, *inter alia*, Illinois, Indiana, Maryland, Pennsylvania, Texas and West Virginia statutes). The pre-need contract may include language declaring the consumer's payments to such a trust to be irrevocable. Such language enables consumers who need to dispose of assets to qualify for Medicaid or for Supplemental Security Income without incurring a penalty. *See* MITFORD, REVISITED at 268-69 (discussing this subject), Frank, *Preneed Funeral Plans* at 9 (same) and *id.* n.36 (citing 42 U.S.C.A. §§ 1381-1383(d) (West 1991 & Supp. 1995)). *See also Ind. Family & Soc. Servs. Admin. v. Culley,* 769 N.E.2d 680, 683 (Ind. Ct. App. 2002) and authorities cited there (discussing exemption of transfer of irrevocable Indiana funeral trusts from Medicaid applicant asset transfer restrictions).

The beneficiary, and the ownership of the beneficial interest in the trust corpus, also varies among the states that have enacted statutes on these subjects. Of the states in which the members of the taxpayer's Indiana affiliated group were incorporated or had outlets, Michigan, like twenty-one other states, requires the trust funds to be held for the benefit of the consumer or decedent. *Id.* at 8 & n.32 (listing statutes from twenty-two states that so require, including, *inter alia*, MICH. COMP. LAWS ANN. § 328.222(1) (West 1992)). Illinois and West Virginia are two of four states whose trust statutes do not specify a beneficiary. *Id.* at 8 & n.34 (listing statutes from four such states, including, *inter alia*, Illinois and West Virginia). However, in Florida, where the Department finds the greatest number of the taxpayer's outlets to have been incorporated or located, and in Indiana, the beneficiary is the seller or provider of the funeral services. *See id.* at 8 n.33 (citing Florida and Indiana statutes). *See also id.* at 27-28 (stating that "in Florida, the statutory language makes it clear that the certificate holder (seller) is the owner of funds paid into trust[]") and *id.* at 28 n.155 (citing FLA. STAT. ANN. § 497.415(1) (West 1988 & Supp. 1995)). If the taxpayer had the beneficial interest in the Florida trust accounts' principal it follows that it also had the beneficial interest in any income those trust accounts earned.

C. THERE IS EVIDENCE THAT THE TAXPAYER CONTRACTED WITH CONSUMERS TO USE THE PRE-NEED TRUSTS' CORPUSES AND INCOMES AS ITS OWN.

The taxpayer further strengthened its claims to the trusts' corpuses and incomes by contracting with consumers to that effect, thereby insuring it would receive those sums in states whose statutes permitted, or that at least did not clearly bar, that practice. As noted under the Discussion of Issue I, the auditor included several completed copies of a form Prepaid Funeral Retail Installment Contract of the parent in the workpapers of its gross retail (sales) and use tax audit, which partly overlapped the taxpayer's income tax audit period. The Department will assume for purposes of this letter, without finding, that the members of the taxpayer's Indiana affiliated group used this or a substantially similar form pre-need contract in other states, in light of the protestant's failure to submit a copy of any other such contract any of them may have used, and given the taxpayer's centralization of administrative operations, presumably including professional legal services. Two paragraphs of this contract set out the parent's rights as between it and the consumer on the questions of entitlement to trust corpus and income, among other matters:

> 7. Interest will accrue to the trust account(s) and *the principal and interest earned shall inure to the benefit of the beneficiary of the trust(s) (SELLER)* to cover all costs incident to the beneficiary's performance of this Agreement, any excess shall be refunded to the PURCHASER, their estate or their heirs at law. Disbursement of funds discharging this Agreement may be made by the Trustee, upon receipt of evidence satisfactory to Trustee that the Agreement has been performed. PURCHASER represents and acknowledges that PURCHASER understands the IRREVOCABLE nature of such trust(s).
>
> 8. *PURCHASER hereby appoints and irrevocably designates SELLER as PURCHASER's agent and attorney-in-fact with respect to PURCHASER's interest in the trust account(s) and all matters pertaining to same.* The Trustee shall be permitted to follow all lawful instructions of SELLER. PURCHASER empowers Trustee to invest in a life insurance or annuity policy or policies, the owner and beneficiary of which shall be the Trustee. *This power of attorney is coupled with an interest, is irrevocable, and shall not be affected by PURCHASER's subsequent death, disability or incapacity.*

(Emphases added.)

As can be seen, Paragraph 7 gave the parent (and presumably the other members of the taxpayer's Indiana affiliated group) the beneficial interest in the trust principal and income to the extent necessary to perform the contract. The consumer or the consumer's estate would get a refund only if there were any excess over that amount. However, the parent (and presumably the taxpayer) included other language in Paragraph 8 to insure that it would have immediate beneficial ownership of the entire trust corpus and income, including any such excess. In that

paragraph the consumer grants the seller an irrevocable power of attorney coupled with an interest. The Department presumes that the parent chose this language intentionally and with full understanding of its effect. It is well settled at common law that where a power of attorney is coupled with a vested interest in the property that is the subject of the power, both the power and the interest survive the principal's death, the power does not create an agency and the putative agent becomes the principal concerning the interest. *Hunt v. Rousmanier's Adm'rs,* 5 L.Ed. 589, 597(U.S. 1823) (Marshall, C.J.); *see also, e.g., Whidden v. Sunny South Packing Co.,* 162 So. 503, 505 (Fla. 1935) and *Hawley v. Smith*, 45 Ind. 183, 203-06 (1873) (both quoting *Hunt*).

The parent, and any subsidiaries with Florida operations, had the beneficial interest in the Florida pre-need trusts by statute, and by extension to their income as well. By virtue of the power-coupled-with-an-interest language in Paragraph 8 of the form Prepaid Funeral Retail Installment Contract, the parent (and presumably the taxpayer) also had the beneficial interest in the other out-of-state pre-need trusts' principal and income in all states in which it operated that recognized such language. The taxpayer thereby was entitled to treat the earnings on all those trust deposits as its own. Such evidence as the protestant has submitted indicates that the taxpayer did exactly that. In addition to the Form 1041 for calendar 1995 for the grantor trust the parent created, mentioned in the Discussion of Issue I above, the taxpayer also submitted Forms 1041 for calendar 1995 for three pre-need merchandise trusts. Schedule K-1 (Beneficiary's Share of Income, Deductions, Credits, etc.) of each return indicates that the parent is the beneficiary. The returns also indicate, for that year at least, the entire adjusted total income earned during the year and indicated on Line 17 was distributed to the parent, for which the trusts claimed income distribution deductions on Line 18 of the 1041s. All four trusts are maintained out-of-state and are named after out-of-state subsidiaries or locations of the parent. The grantor trust is maintained in Florida. The other three are maintained in Pennsylvania. One of the three has the same name as one of four wholly owned Pennsylvania subsidiaries that the parent merged into itself effective December 31, 1991 and operated thereafter as outlets under its own name. The Department cannot identify the other two pre-need trusts from the names appearing on their respective 1041s as relating to any location maintained by a member of the taxpayer's Indiana affiliated group.

D. THE PRE-NEED TRUSTS' LEGAL SITUSES AND THE TRUSTEES' DOMICILES ARE IRRELEVANT TO THE QUESTIONS OF THE SITUSES OF THE TAXPAYER'S EQUITABLE INTERESTS IN THE TRUSTS AND ITS GROSS INCOME TAX LIABILITY ON THE DISTRIBUTED INTEREST AND DIVIDEND INCOME.

As previously noted, the protestant contends that the Department cannot assess gross income tax on the interest and dividends the pre-need trusts distributed to the taxpayer because the trust securities that generated that income were managed and maintained out of state. However, as a pure question of Indiana's power to tax, the fact that *legal* title to the pre-need trust assets may have been maintained in other states does not bar the Department from taxing the trust income distributed to the *equitable* owner of the corpus (i.e., the taxpayer). *See Maguire v. Trefry,* 40 S.Ct. 417, 419 (U.S. 1920) (holding that Massachusetts could tax the income a Massachusetts beneficiary received from a trust consisting of assets held and administered in Pennsylvania), reaffirmed in *New York ex rel. Cohn v. Graves,* 57 S.Ct. 466, 468 (U.S. 1937). *See also Guaranty Trust Co. v. Virginia,* 59 S.Ct. 1, 3 (U.S. 1938) (holding that Virginia could levy an income tax on a

trust beneficiary residing in Virginia even though the New York trustees had paid New York taxes on the same income), citing *Lawrence* and *Cohn*, discussed under Issue I above. As found there, the taxpayer was an Indiana domiciliary whose income Indiana had full power to tax. The taxing of income distributed to the taxpayer as a beneficiary of out-of-state trusts is merely a specific application of this general power. The domiciles of the various trustees thus are irrelevant to this question. Whatever effect they may have for these trusts' respective gross receipts, fiduciary income or property tax liabilities in other states, the trustees' domiciles have no bearing on whether the taxpayer was, and the protestant as its successor in interest is, subject to gross income tax on the distributed income and dividends.

The physical locations of the trusts' respective assets are also irrelevant as a matter of Indiana gross income tax law. The protestant stated that the interest and dividends the taxpayer received derived from securities, i.e. intangible personal property, held in the pre-need trusts. The taxpayer's beneficial interests in the respective pre-need trusts were therefore also intangible to that extent. "Unless statutes provide otherwise, the beneficial estate or interest of the cestui que trust is subject to the same incidents, properties and consequences as attach to similar legal estates and interests." 90 C.J.S. *Trusts* § 240, at 367 (2002). "[I]f the trust property is personal property, the interest of the beneficiary is personal property[.]" RESTATEMENT (SECOND) OF TRUSTS § 130(a) (1959). The authorities discussed under Issue I above used to determine the tax situs/es of intangibles therefore apply as well to the taxpayer's equitable interests in the pre-need trusts as their beneficiary, to the extent that they derived from intangibles. Former 45 IAC § 1-1-51, eighth paragraph stated that "*[t]he physical location of the intangible at the time any income is received* under either the 'business situs' test or the 'commercial domicile' test *is not a controlling factor* but will be considered in view of all of the facts presented." *Id* (emphases added). In the specific context of the pre-need trust intangibles the taxpayer as beneficiary used in its business, the physical locations of the trusts' constituent intangibles are only relevant in determining the respective legal situses of those intangibles and any corresponding liabilities of the pre-need trusts for tax imposed by the trustees' respective domiciliary states. Given that the respective business situses of those intangibles could in principle be completely different from their legal situses, the intangibles' physical locations are irrelevant to the question of whether the taxpayer is liable for Indiana gross income tax.

In short, the question is not whether the pre-need trustees, as holders of the legal titles to the respective trusts' intangibles, may have managed and maintained those intangibles outside Indiana. The legal situs/es of those intangibles for purposes of the tax laws of other states might very well be different from the tax situs/es of the taxpayer's equitable interests in those intangibles for Indiana gross income tax purposes. The real issue, in terms of the authorities discussed under Issue I, is what the tax situs/es of those equitable interests were, which can only be determined from evidence of where and how the taxpayer used them in its business.

E. THE PROTESTANT'S EVIDENCE FAILS THE "BUSINESS SITUS" TEST.

To prove that the assessment of gross income tax on the distributed trust interest and dividends was wrong, the protestant has the burden of proving that its use of the intangibles the pre-need trusts purchased, and the distributed interest and dividends those intangibles generated, were "'directly related to an integral part of a business regularly conducted at [its]'business situs[es]'

outside Indiana.'" 45 IAC § 1-1-51, sixth paragraph, *quoted in Bethlehem Steel II,* 639 N.E.2d at 268. Specifically, the taxpayer has to prove that its members regularly used its equitable interests in those intangibles and their distributed income in the business operations of the respective out-of-state business locations for which it named the pre-need trusts. Doing so thereby would have given those interests out-of-state tax or business situses as well. However, the Department, after reviewing the evidence the protestant has submitted, finds that it has failed to sustain this burden of proof, as discussed below.

Strictly speaking, two of the three Forms 1041 the protestant has submitted for the merchandise trusts in question are irrelevant to the protestant's argument on this issue, in that neither of the subsidiaries or locations for which these trusts were named were members of the taxpayer's Indiana affiliated group during the audit period. These two returns therefore do not necessarily prove how the taxpayer treated the income it received from pre-need trusts named for locations maintained by members of that group.

However, even if they had been for such locations, neither they nor the 1041s for the Florida grantor trust and the merged Pennsylvania location help the protestant's argument. All four returns indicate that the parent received each of the trusts' entire adjusted total incomes for the year, and nothing else. The returns do not indicate any effective legal restrictions on the purposes for which the parent could use the distributed income, nor what it in fact did with the income once received. Nor has the protestant submitted any other evidence on these points. It has not submitted any records to the hearings officer, such as copies of the respective documents that created each trust, indicating that trust beneficiaries' use of the income was restricted to fulfilling pre-need contracts performed at, or to subsidizing the day-to-day operations of, the locations to which the trusts related. Paragraph 7 of the Prepaid Funeral Retail Installment Contract does state that "interest earned [would] inure to the benefit of the beneficiary of the trust(s) (SELLER) to cover all costs incident to the beneficiary's performance of this Agreement[.]" However, the power-coupled-with-an-interest language of Paragraph 8 of the same agreement in effect removed this restriction by enabling the taxpayer to treat the distributed earnings as its own. Most importantly, however, the protestant did not submit any books or records to the hearings officer indicating that the parent or any other member actually used distributed trust income to fulfill pre-need contracts at, or to subsidize day-to-day operations of, the namesake locations for the pre-need trusts. Nor has the protestant submitted any books or records indicating that the Michigan pre-need trust either held that income for, or distributed it to the respective consumers or on behalf of the respective decedents, as MICH. COMP. LAWS ANN. § 328.222(1) would seem to imply. Given this lack of a record, there is nothing to indicate that the taxpayer did not use the income distributed from the pre-need trusts for any business purpose of, or at any location maintained by, any member.

F. CONCLUSION: THE "COMMERCIAL DOMICILE" TEST APPLIES AND THE DISTRIBUTED INTEREST AND DIVIDEND TRUST INCOME IS SUBJECT TO INDIANA GROSS INCOME TAX.

The protestant has thus failed to sustain its burden of proof that the taxpayer's intangible equitable interests in the pre-need trusts had out-of-state tax situses, i.e. that they were "integrally connected with [the] taxpayer's '[out-of-state] business situs[es.]' " *Bethlehem Steel*

I, 597 N.E.2d at 1334. Indiana being the taxpayer's commercial domicile, the auditor was correct to propose assessments of gross income tax on the interest and dividends distributed from the pre-need trusts. Even if the protestant had proved its case, the interest and dividends received by the Indiana parent (as distinguished from the out-of-state subsidiaries) would still have remained gross income taxable by Indiana by virtue of former IC § 6-2.1-1-2(d), which specifically refers to "interest or dividends," *id.*

FINDING

The Department denies the protest as to this issue.

III. Gross Income Tax—Definition of "Gross Income"—Amortization of Intangibles—Pre-Need Trusts

Gross Income Tax—Definition of "Gross Income"—Amortization of Intangibles—Situses of Intangibles

DISCUSSION

A. THE PARENT'S ACQUISITION OF, BOOK AMORTIZATION OF THE PRE-NEED TRUSTS RELATED TO, AND STATUS DURING THE AUDIT PERIOD OF, TWO TEXAS MORTUARIES

The parent acquired two Texas mortuaries with cemeteries attached in 1985 and 1986. After these two acquisitions, the parent decided to amortize the respective pre-need trusts maintained and administered in connection with each of these facilities, as each of those trusts was constituted on each acquisition's closing date. To do so the parent created a category on its chart of accounts it called "Pre-Need Trust Amortization," and each year of the audit period it recognized a certain amount of this amortization on its books. It merged one of the Texas mortuaries into itself at the end of calendar 1991, along with the four wholly owned Pennsylvania cemetery subsidiaries mentioned above in the Discussion of Issue II. As it did with those latter mortuaries, the parent thereafter ran the merged Texas mortuary as an outlet under its own name. The other one merged into the parent immediately after the end of the audit period, but remained a wholly owned subsidiary during that time.

B. THE TAXPAYER'S FEDERAL INCOME TAX TREATMENT OF THE AMORTIZATION OF THE TEXAS PRE-NEED TRUSTS

The taxpayer was also able during the audit period to begin deducting each year's pre-need trust amortization on its federal Forms 1120 due to major changes in federal tax law on depreciation and amortization of goodwill-related intangibles that occurred in the second half of the taxpayer's 1993 fiscal year. On April 20, 1993 the United States Supreme Court issued its opinion in *Newark Morning Ledger Co. v. United States*, 113 S.Ct. 1670 (U.S. 1993). The Court held that "a taxpayer able to prove that a particular [customer-based intangible] asset can be valued and that it has a limited useful life may depreciate its value [under I.R.C. (26 U.S.C.) §

167(a)] over its useful life regardless of how much the asset appears to reflect the expectancy of continued patronage, [i.e., goodwill]…." *Id.* at 1681. On August 10, 1993, less than four months later, Congress enacted I.R.C. § 197 (1988 & Supp. V 1993) (1994) in the Revenue Reconciliation Act of 1993 (Omnibus Budget Reconciliation Act of 1993, Title XIII), Pub. L. No. 103-66, § 13261, 107 Stat. 416, 532-541. Section 197 grants an amortization deduction for goodwill, customer-based and other types of intangibles identified therein as being amortizable, and sets out general rules under which federal income taxpayers may, and restrictions on when they may not, amortize them. Circumstantially, however, it appears unlikely that the taxpayer used I.R.C. § 197 for two reasons. First, subparagraph (e)(1)(A) of that section explicitly excludes interests in trusts from the definition of "section 197 intangible" in I.R.C. § 197(d). Second, the taxpayer chose a twenty-year useful life over which to amortize the pre-need trusts rather than the fifteen-year period for which I.R.C. § 197(a) provides. The Department therefore assumes for purposes of this discussion, without finding, that the taxpayer claimed its deductions under I.R.C. § 167(a) as interpreted in *Newark Morning Ledger* instead of I.R.C. § 197.

C. THE AUDITOR'S ADJUSTMENT

The auditor treated the pre-need trust amortization figures, which he took from reports the taxpayer used to prepare its 1120s, as gross income. He did not give an explicit reason why he believed such was the case, but he allocated them to the taxpayer's Indiana commercial domicile. The Department infers from this allocation that the auditor believed the sums amortized to be derived from intangible personal property. That property specifically consisted of the parent's and the remaining Texas subsidiary's respective equitable interests in the deposited pre-need contract payments, and intangible personal property purchased with those deposits for investment, constituting the pre-need trusts' corpuses. Each of those equitable interests included the parent's and the remaining Texas subsidiary's rights to receive a distribution of corpus each time they performed a pre-acquisition pre-need contract for which payments had been deposited. Their rights to receive, and actual receipts of, those distributions were in turn the legal and factual bases, respectively, for the amortization of the trusts. The auditor proposed to assess gross income tax on the amortized sums at high rate pursuant to former 45 IAC § 1-1-112 (1992), which imposed gross income tax at high rate on gross income derived from sources not otherwise described in the Gross Income Tax Act and the regulations. *See also* former IC § 6-2.1-2-5(9) (imposing gross income tax at high rate on any activity on which tax is not assessed at low rate).

D. THE PROTESTANT'S ARGUMENTS

The protestant has challenged these parts of the proposed assessments on two grounds. First, it asserts that the pre-need trust amortization is not gross income. Second, it claims that the amortization is related to the purchase of non-Indiana business locations, in essence claiming that the sums amortized derive from out-of-state business situses and that the "commercial domicile" rule is therefore inapplicable. The Department agrees with the protestant's first argument, for the reasons set out below, making it unnecessary to address the second argument.

E. THE TAXPAYER'S FEDERAL INCOME TAX DEDUCTIONS FOR PRE-NEED TRUST AMORTIZATION WERE NOT GROSS INCOME.

1. The Pre-Need Trust Amortization Deductions Were Not "Receipts."

a. Gross Income Means Gross "Receipts," Which Includes "Credits" and "Other Property."

Former IC § 6-2.1-1-2(a) defined "gross income" as "all the gross *receipts* a taxpayer receives" from the categories that subsection enumerates. *Id* (emphasis added). Former IC § 6-2.1-1-10 defined "receipts" as being "cash, notes, *credits, or other property* that is received by a taxpayer or a third party,…for the taxpayer's benefit." *Id* (emphasis added). The pre-need trust amortization deductions were plainly not cash or notes, so the only possible bases on which the auditor could have classified them as receipts was on the theory that they were either "credits" or "other property." The Department will examine each of these classifications in turn.

b. The Pre-Need Trust Amortization Deductions Were Not "Credits" as the Definition of "Receipts" Uses That Word.

In *Indiana Department of State Revenue v. Colpaert Realty Corp.*, 109 N.E.2d 415 (Ind. 1952), the Indiana Supreme Court had to define "credit" as used in § 1(h) of the Gross Income Tax Act of 1933 (ch. 50, 1933 Ind. Acts 388, as added by ch. 370, sec. 1, 1947 Ind. Acts 1471, 1474), a predecessor of former IC § 6-2.1-1-10. The court said:

> In the case of *Gardner-White Co. v. Dunckel* (1941), 296 Mich. 225, 295 N.W. 624, it was said that the term "credit" as used in [Michigan's] General Sales Tax Act defining the phrase "gross proceeds," "[']represents a type of property . . . that is capable of being borrowed upon or discounted at financial institutions. It is an item of incorporeal personal property just as much as a share of stock or a bond, chattel mortgage, real estate mortgage or other form of collateral.[']" [296 Mich. at 233, 295 N.W. at 627 (quoting and adopting the definition of the trial court).]
>
> It is in this sense, we think, that the phrase "credits and/or other property" was used in § 1 (h) of the [Indiana gross income tax] statute. *The word* [credit] *as there used imports the existence of something of value which may presently be demanded by the one in whose favor the credit is created, if one is created; something of value capable of being withdrawn and used; a claim or demand for money or other thing of value presently existing.*

Id. at 420 (emphasis added).

A "credit" as former IC § 6-2.1-1-10 used that word is therefore an intangible asset that can be made immediately available as money or other present value, and is immediately usable, upon demand of the person entitled to it (i.e., the creditor/taxpayer). The classic example would be a

checking or passbook account or other demand deposit in a financial institution.

In contrast, a taxpayer cannot simply demand that the IRS allow it a deduction, or demand a refund based on a claimed deduction, without more. "[T]he burden of clearly showing [the IRS] the right to [a] claimed [federal income tax] deduction is on the taxpayer." *INDOPCO, Inc. v. Comm'r,* 112 S.Ct. 1039, 1043 (U.S. 1992) (internal quotation marks omitted). A taxpayer's burden of proof of entitlement to a depreciation deduction for customer-based, goodwill-related intangibles in particular is "substantial" and "often …too great to bear." *Newark Morning Ledger,* 113 S.Ct. at 1683 and 1681, respectively.

The taxpayer therefore was anything but entitled to demand that the IRS recognize the pre-need trust amortization deductions. The taxpayer would have had to rigorously prove its entitlement to those deductions to the satisfaction of a presumably very skeptical IRS in any audit of its 1120s for the audit period, and thereafter if necessary in the federal courts. The pre-need trust amortization deductions thus do not fit the definition of "credit" as it is used in former IC § 6-2.1-1-10 or, by extension, that statute's definition of "receipts." Nor could the taxpayer have received those deductions as former IC § 6-2.1-1-11 defined "receives," since they could not be "credit[ed] to the taxpayer," *id.* The auditor erred in classifying the pre-need trust amortization deductions as gross receipts, and by extension as gross income, from intangible personal property to the extent that he may have believed them to be credits.

c. The Pre-Need Trust Amortization Deductions Were Not "Other Property" as the Definition of "Receipts" Uses That Term, and as Indiana Judicial Precedent Defines "Property."

Nor do the deductions constitute "other property" as IC § 6-2.1-1-10 uses that phrase. In *Department of Insurance v. Motors Insurance Corp.,* 138 N.E.2d 157 (Ind. 1956), the Indiana Supreme Court gave the following definitions of "property":

> This court in *Dept. of Financial Inst. v. General Finance Corp.* (1949), 227 Ind. 373, 384, 86 N.E. 2d 444, 10 A.L.R. 2d 436, quoting from *Buchanan v. Warley* (1917), 245 U.S. 60, 74, 62 L. Ed. 149, 161, 38 S. Ct. 16, said:
>
> > "'Property is more than the mere thing which a person owns. It is elementary that it includes the right to acquire, *use, and dispose* of it. The Constitution protects these essential attributes of property. *Holden v. Hardy*, 169 U.S. 366, 391, 42 L. Ed. 780, 790, 18 S. Ct. 383 [(1898)]. Property consists of the free *use, enjoyment, and disposal* of a person's acquisitions without control or diminution save by the law of the land.'" [86 N.E.2d at 448, quoting 38 S.Ct. at 18.]
>
> "Property" in its legal sense means a valuable right or interest in something rather than the thing itself, and is the right to possess, *use and dispose* of that

> something in such a manner as is not inconsistent with law. *Dept. of Financial Institutions v. Holt, etc.* (1952), 231 Ind. 293, 303, 108 N.E.2d 629, 634; *Meek v. State* (1933), 205 Ind. 102, 105, 185 N.E. 899.

138 N.E.2d at 162-163 (emphases added by the Department).

"The term [property] includes valid contracts." *Holt,* 108 N.E.2d at 634, citing *General Finance,* 86 N.E.2d at 448. The pre-need contracts between the two Texas mortuaries and the various consumers who entered into them before the parent acquired those mortuaries thus were property. So were the previously discussed equitable interests of the parent, as successor in interest to one of those mortuaries, and of the remaining mortuary, in the corpuses of the pre-need trusts respectively maintained in connection with those locations. Those corpuses included deposits of payments made under contracts consumers had entered into with the two funeral homes prior to the parent's respective acquisitions of them. The parent and the remaining mortuary also had, as part of their equitable interests in the trusts, the rights to receive distributions of corpus upon their respective performances of pre-need contracts at the two Texas locations. Once deposited to those locations' respective operating accounts, the received corpus distributions became subject to the parent's periodic sweeps of those accounts mentioned in the Statement of Facts. The parent thereafter could use those distributions in the operation of the taxpayer's business, i.e. the business of the entire affiliated group. To the extent that those distributions represented pre-acquisition deposits of pre-need contract principal, the parent and the remaining Texas mortuary thereby depreciated those trusts, for which the taxpayer was entitled to claim deductions under I.R.C. 167(a) as interpreted in *Newark Morning Ledger* for each year of the audit period.

However, the rights to claim those deductions, standing alone, were not property because the taxpayer could not acquire or dispose of them independently of the parent's and the remaining Texas mortuary's respective equitable interests in the pre-need trusts, from which those rights derived. This finding follows from a fundamental rule of federal income tax law that applies here. That rule is that "[u]nless there is a specific statutory provision to the contrary, a taxpayer ordinarily reports his own income and takes his own deductions." *Davis v. United States,* 110 S.Ct. 2014, 2023 (U.S. 1990). I.R.C. § 167 does not have a provision allowing any entity other than a taxpayer who owns an interest in depreciable property to claim a depreciation deduction. Any putative buyer of the pre-need trust depreciation deductions thus would not have been able to claim them legally on its federal income tax returns for the reporting periods covering the audit period. If any such "buyer" had done so and had its returns audited, the IRS presumably would have disallowed the "bought" deductions. Although the taxpayer in the *Bethlehem Steel* case did sell federal tax attributes, it was only able to do so because former I.R.C. § 168(f)(8) (repealed 1986) explicitly made such a sale possible. Thus, in contrast to its being controlling authority under Issues I and II above and Issue IV below, the *Bethlehem Steel* opinions do not control on the more specific question of whether the pre-need trust depreciation deductions were property under Indiana law. They are legally distinguishable on this particular point from the present issue because that case arose under a former paragraph of the Internal Revenue Code structured differently than I.R.C. § 167.

In light of the foregoing analysis, the Department finds that the auditor erred in classifying the pre-need trust depreciation deductions as gross receipts, and by extension as gross income, from intangible personal property, to the extent that he may have believed them to be property.

2. Since the Pre-Need Trust Amortization Deductions Were Not "Receipts," They Could Not Be "Gross Income."

The pre-need trust amortization deductions were not "receipts" as former IC § 6-2.1-1-10 defined that word, nor could the parent or the remaining Texas mortuary have received them as former IC § 6-2.1-1-11 defined "receives." By extension, the deductions also were not "gross income" as former IC § 6-2.1-1-2(a) defined that term.

Since the deductions were not credits or other intangible personal property capable of having a situs, it is unnecessary for the Department to determine their tax situs state under the authorities discussed under Issue I above. The Department therefore respectfully declines to address the protestant's second argument on the present issue.

FINDING

The protest is sustained as to this issue.

IV. Gross Income Tax—Imposition on Domiciliary—Source State of Gross Income—(Insurance Commissions)(Fiscal Year Ending 09/30/1993)

DISCUSSION

A. OVERVIEW OF INSURANCE FUNDING OF PRE-NEED CONTRACTS

> Another method of funding preneed funeral contracts is through the use of an insurance policy or annuity plan. With insurance policies, the consumer purchases, either in a lump sum or by installments, a funeral or burial policy. The consumer names the seller or the funeral provider as the beneficiary of the insurance or annuity policy. The benefit is paid out at the death of the consumer or the decedent. An annuity plan works essentially the same way, except that the consumer pays the seller or provider in installments over a specified period of time.

Frank, *Preneed Funeral Plans* at 9-10 (footnotes omitted). *See also Ind. Family & Soc. Servs. Admin. v. Culley,* 769 N.E.2d 680, 683-684 (Ind. Ct. App. 2002) (holding that FSSA abused its discretion in imposing a Medicaid disqualification asset transfer penalty on a Medicaid recipient who had used cash to buy insurance policies to fund such trusts for her children and their spouses). "The seller…arranges for any necessary insurance policy underwriting." Frank, *Preneed Funeral Plans* at 18-19 (footnote omitted). The mortuary or cemetery company thus commonly doubles as an insurance agent in a pre-need contract transaction. The entity

responsible for closing the sale, whether that company or some other entity acting on its behalf, therefore can collect two commissions: one for the pre-need contract itself, and a second one for selling the insurance.

B. THE TAX TREATMENT OF THE TAXPAYER'S CREDIT LIFE INSURANCE OPERATION AND THE PROTESTANT'S ARGUMENTS

During the audit period the parent owned an Indiana-chartered insurance company that issued policies of credit life insurance. Credit life insurance is defined as "insurance on the life of a debtor pursuant to or in connection with a specific loan or other credit transaction." IC § 27-8-4-2(b)(1) (1988) (1993). The insurer issued these policies to consumers who entered into pre-need contracts and who chose to take out such policies as a contingent method of paying off any outstanding balance under the pre-need contract at the consumer's death. *See generally* Consumer Credit Protection Act § 106(b), 15 U.S.C. § 1605(b) (1988) (1994) requiring the creditor to include credit life, accident and health insurance premiums in the finance charge unless the debtor receives written disclosures that insurance is not a factor in the decision to extend credit and of the cost of the insurance, and the debtor indicates the desire for such insurance in writing). *See also* Federal Reserve Bd. Regulation Z (Truth-in-Lending Regulations) § 226.4(d)(1), 12 C.F.R. § 226.4(d)(1) (1992-95) (permitting exclusion of credit life insurance premiums from the finance charge if the fact that the creditor does not require, and the premium for the initial term of, such insurance are disclosed, and the consumer signs or initials a written request for the insurance).

The taxpayer reported the receipts of this insurer for gross income tax purposes during the audit period net after deducting what the auditor characterized in the Audit Summary as "management fees." The auditor adjusted the taxpayer's liability by proposing to assess gross income tax at high rate on these deducted sums. The protestant objects to the parts of the assessments on these receipts, characterizing them as sales commissions the insurer paid to two Subchapter S Kentucky and Ohio corporations commonly owned by the parent's individual shareholders on the policies that those corporations sold. According to the protestant, these sums are not subject to gross income tax for two reasons. First, they were earned by out-of-state locations (i.e., the intangibles that gave rise to them had business situses outside Indiana). Second, and in the alternative, the insurer received the sums as an agent of, and immediately turned them over to, the Kentucky and Ohio Subchapter S corporations.

C. THE PROTESTANT HAS SUBMITTED NO EVIDENCE TO SUPPORT ITS OUT-OF-STATE-TAX-SITUSES ARGUMENT.

1. There Is No Evidence That Either the Ohio or the Kentucky Subchapter S Corporation Sold, or Earned Commissions From the Sale of, the Credit Life Insurance Subsidiary's Policies.

The protestant has not submitted any evidence or authority to support either its out-of-state business situs assertion or its agency assertion. Turning first to the claim of out-of-state business situses, the Department notes at the outset that the protestant did not submit any evidence to the hearings officer indicating that the assessed sums in fact consisted of commissions, rather than of "management fees" as characterized in the Audit Summary. However, assuming without

deciding that the sums in question were in fact commissions, the Department notes that the protestant's claim suffers from much the same deficiencies as were discussed under Issue I when it made the same claim concerning pre-need contract interest. As stated in that discussion, "the protestant has provided no evidence indicating the office of the taxpayer through which each [installment] pre-need contract was marketed, negotiated and brought into being, [and] the office (if different) that decided to approve the contract and extend credit to each consumer, that kept the payment accounts and other records of executory contracts[.]" Similarly, concerning the present issue, the protestant submitted no evidence whatever to the hearings officer that the Ohio or Kentucky Subchapter S corporations in fact made the sales out of which the alleged commissions arose.

2. There Is No Evidence That Either the Ohio or the Kentucky Subchapter S Corporation, or Any Officer or Employee of Either Corporation, Was a Licensed, Registered Insurance Agent.

There is nothing in the protest record to indicate that these corporations were even licensed, appointed insurance agents entitled as such to receive commissions. During the audit period both Kentucky and Ohio, among other states, barred (and still bar) an insurer from paying, or an agent from receiving, a commission if the agent does not hold a license. Ch. 171, § 6, 1982 Ky. Acts 417, 420, codified at 11A KY. REV. STAT. ANN. § 304.9-425(Michie 1996 & 2001 Repls.) (current version at 11A KY. REV. STAT. ANN. § 304.9-425(1)-(2) (Cum. Supp. 2003); OHIO REV. CODE ANN. §§ 3905.18(A)-(B) and 3905.181 [sic; should read "3905.18.1"] (Anderson 1996 & 2002 Repls.) (same, respectively). *See also* 43 AM.JUR.2D *Insurance* § 147 (2003) (same) and 44 C.J.S. *Insurance* § 205, at 389 (1993) (same). However, the protestant did not submit copies of official records of the Ohio or Kentucky state insurance departments of any insurance agent licenses issued to the Ohio or Kentucky Subchapter S corporations, or any of their officers or employees. Nor has the protestant provided this Department with copies of any official records of the heads of the Ohio or Kentucky state insurance departments evidencing that the insurer registered its appointment of the Ohio and Kentucky Subchapter S corporations, or any of the individuals previously mentioned, as the insurer's agent in those corporations' respective markets. Both jurisdictions require registration of such appointments. 11A KY. REV. STAT. ANN. § 304.9-270(1); OHIO REV. CODE ANN. § 3905.20(B)(1).

3. There Is No Evidence That an Insurer/Insurance Agent Contractual Relationship Existed Between the Credit Life Insurance Subsidiary and Either the Ohio or the Kentucky Subchapter S Corporation, or Any Officer or Employee of Either Corporation.

The protestant also failed to submit copies of any insurance agency contract/s that may have existed between either of the Subchapter S corporations, or any of their officers or employees, and the insurer. Any such contract would have been relevant evidence of the existence of an insurer/insurance agency relationship, since the contract would specify the terms of the agency. "The parties have the right to agree upon the terms of a contract of agency, and their rights are determined by the provisions of such contract[.]" 13 ERIC MILLS HOLMES, HOLMES' APPLEMAN ON INSURANCE 2D: LAW OF INSURANCE AGENTS § 95.1, at 478 (LEXIS Publ'g 1999) (hereinafter HOLMES' APPLEMAN ON INSURANCE 2D); *see also* opinions cited at 13 *id.* n.19. Whether the Ohio and Kentucky Subchapter S corporations, or any of the previously mentioned individuals, could approve insurance applications for, or otherwise bind the insurer to issue, policies on their

own authority might have been among those terms. The presence or absence of such authority would have been a relevant (but not the only) factor for the Department to consider in determining whether or not the Subchapter S corporations had business situses for insurance (as distinguished from mortuary or cemetery) purposes. *See* 45 IAC § 1-1-49(5) (stating that one way of establishing a business situs, either in Indiana or another state, is "[a]cceptance of orders without the right of approval or rejection in another state[,]" *id.*). The terms of the contract/s also would have included those upon the occurrence of which the agent would earn a commission. 13 HOLMES' APPLEMAN ON INSURANCE 2D § 97.2, at 642; 43 Am.Jur.2d *Insurance* § 146 (1982); 44 C.J.S. *Insurance* § 205, at 389 (1993) and 2A C.J.S. *Agency* § 334, at 606 (2003). Lastly, the protestant failed to submit to the hearings officer copies of any books or records to indicate that the Subchapter S corporations, or any of their officers or employees, in fact sold any life insurance policies of the insurer or earned any commissions as a result of any such sales. Such records could have included, for example, insurance applications approved by the putative agents and policies (including declarations pages identifying the consumer) the insurer issued based on such applications.

4. There Is Thus No Evidence of Any Out-of-State Tax Situs Out of Which the Alleged Commissions Arose.

Applying the precedents discussed under Issue I, the protestant has wholly failed to show any relationship between any supposed intangibles (i.e., any insurance agency license, registration, agency contract and sold policies) from which the alleged commissions may have arisen and the Ohio or Kentucky Subchapter S corporations' respective business situses. Even assuming (without finding) that all of these intangibles existed, the protestant has not proved that either of the Subchapter S corporations performed any activity related to the putative intangibles at its business situs, or the degree of any such activity. In particular, the protestant has failed to prove that either of the Subchapter S corporations marketed, negotiated, sold, had actual or implied authority to approve issuance of, and serviced the insurer's policies at and through that corporation's business situs. An office, other than the headquarters, of a taxpayer whose regular income derives from sales has a business situs at that office only if it is engaged in such activity and has independent authority to enter into sales contracts. *See Miami Coal*, 176 N.E. at 16 (out-of-state office that serviced accounts receivable arising from its sales of coal was business situs of accounts receivable for property tax purposes), approved in *Bethlehem Steel II*, 639 N.E.2d at 269-270. *See also* former 45 IAC § 1-1-49(5) (stating that one way of establishing a business situs, either in Indiana or another state, is "[a]cceptance of orders without the right of approval or rejection in another state[,]" *id.*).

However, the Department can no more assume that either of these Subchapter S corporations, or any of their officers or employees, conducted insurance sales activities, had authority to approve the policy applications or bind the insurer to issue the policies that gave rise to the alleged commissions, than it could assume that they sold the pre-need contracts the policies were intended to finance. As discussed under Issue I, centralized sales forces are prevalent in the mortuary and cemetery industries. Given these marketing conditions and the fact that the parent and the Subchapter S corporations had common shareholders, it is possible that these three companies, acting in concert, jointly employed such a force to market not only pre-need contracts, but also simultaneously any insurance policies related to them. (In this connection the

Department notes that the original protest letter states the insurer sold credit life insurance. Paragraph 4 and Subparagraph 5(d) of the form Prepaid Funeral Retail Installment Contracts discussed under Issue I gave the consumer the option of purchasing credit life insurance, implying that the contract and the insurance are marketed in the same transaction.) However, as under Issue I, the Department is not finding that the parent or the taxpayer, and the Subchapter S corporations, jointly employed a centralized sales force. It is only finding that the protestant has failed to sustain its burden of production of evidence, and thus its burden of proof, that the Ohio and Kentucky Subchapter S corporations were each operating its own decentralized sales force as an insurance agency under contract with the insurer, with the authority to approve policy applications or bind the insurer to issue policies.

5. The "Commercial Domicile" Test Therefore Applied to Give Any Intangibles Underlying the Alleged Commissions an Indiana Tax Situs.

Given the total absence of evidence that the Ohio and Kentucky Subchapter S corporations were so acting, the "commercial domicile" test of former 45 IAC § 1-1-51 applied. Without proof that either Subchapter S corporation, or any of their officers or employees, had actual or implied authority to approve policy applications or otherwise bind the insurer, the Department can only assume that the insurer had reserved the right to approve applications, making the alleged commissions gross income attributable to Indiana as the state of the insurer's, and the insurer's parent's, commercial domicile. This result is supported not only by the regulation, but also by judicial precedent in Indiana and other jurisdictions, including Ohio and Kentucky, governing when a sales agent (whether in the insurance or some other sales business) earns a commission. "[T]he general rule is that a person employed on a commission basis is entitled to those commissions when the order is accepted by the employer." *Sample v. Kinser Ins. Agency, Inc.*, 700 N.E.2d 802, 804 (Ind. Ct. App. 1998); *see also Vector Eng'g & Mfg. Corp. v. Pequet*, 431 N.E.2d 503, 505 (Ind. Ct. App. 1982) (same, cited in *Sample, id.* and citing opinions from other jurisdictions). "Generally, in the absence of an agreement [or here, proof of an agreement] to the contrary, an agent's commission is earned on the date that the customer is insured by the insurance company." *Ariz. Ins. Guar. Ass'n v. Humphrey*, 508 P.2d 1146, 1148 (Ariz. 1973) (citing *Boro Hall Agency, Inc. v. Citron*, 329 N.Y.S.2d 269, 270-71 (N.Y. Civ. Ct. 1972)), quoted in 13 HOLMES' APPLEMAN ON INSURANCE 2D § 97.8, at 672 and cited at 13 *id.* n.146. *See also Cockrell v. Grimes*, 740 P.2d 746, 749 (Okla. Ct. App. 1987) (same) (quoting *Ariz. Ins. Guar. Ass'n*, *supra*), quoted in 44 C.J.S. *Insurance* § 205, at 389 (1993) and cited at *id.* n.31. "A contract of insurance is consummated [and the agent earns a commission] upon the unconditional acceptance of the application of the insured by the insurer." *Hartford Fire Ins. Co. v. Whitman*, 79 N.E. 459, 461 (Ohio 1906), cited in 43 Am.Jur.2d *Insurance* § 201, at 283 n.47 (1982), *inter alia*. *See also Bishop v. Am. States Life Ins. Co.*, 635 S.W.2d 313, 315 (Ky. 1982) (holding that the agent had earned his commission once the insurer accepted his tender of the insured's application and first premium check, stating that "nothing more was required of [the agent.]" If the Ohio and Kentucky Subchapter S corporations earned their alleged commissions when the insurer accepted their respective consumers' applications, and that acceptance occurred in Indiana, then it follows that the alleged commissions were earned, and were in fact premium gross income attributable to the taxpayer, in Indiana. Thus, the Department can subject the gross income that the management fees or alleged commissions represent to assessment of Indiana

gross income tax unless the protestant can prove that the insurer held them as agent for the Ohio and Kentucky Subchapter S corporations, to which question the Department now turns.

FINDING

The protest is denied as to this issue.

V. Gross Income Tax—Imposition on Domiciliary—Receipt of Gross Income by Insurer as Agent (Insurance Commissions)(Fiscal Year Ending 09/30/1993)

DISCUSSION

A. EVIDENTIARY ELEMENTS AND BURDEN OF PROOF OF AGENCY AND OF GROSS INCOME RECEIVED IN AN AGENCY CAPACITY

During the audit period the Department had codified its gross income tax regulation on agency receipts at former 45 IAC § 1-1-54 (last version at 45 IAC §§ 1.1-1-2 and –6-10), which read in relevant part as follows:

> Sec. 54. Agents. Taxpayers are not subject to gross income tax on income they receive in an agency capacity. However, before a taxpayer may deduct such income in computing his taxable gross receipts, he must meet two (2) requirements:
>
> *(1) The taxpayer must be a true agent. Agency is a relationship which results from the manifestation of consent by one person to another authorizing the other to act on his behalf and subject to his complete control, and consent by the other to so act.* Agency may be established by oral or written contract, or may be implied from the conduct of the parties. *However, the representation of one party that he is an agent of another without a manifestation of consent by the alleged principal is insufficient to establish agency.* Both parties must intend to act in such a relationship.
>
> Characteristic of agency is the principal's right to complete and continuous control over the acts of the agent throughout the entire performance of the contract. This right to control cannot be limited to the accomplishment of a desired result. *In addition, the principal must be liable for the authorized acts of the agent.*
>
> *(2) The agent must have no right, title or interest in the money or property received or transferred as an agent.* In other words, the income received for work done or services performed on behalf of a principal must pass intact to the principal or a third party; the agent is merely a conduit through which the funds pass. A contractual relationship whereby one person incurs expense

> under an agreement to be reimbursed by another is not an agency relationship unless the other elements of agency exist, particularly the element of control, discussed above.….
>
> In summary, when applying the above factors to a taxpayer, *the critical factor is that of control. Notwithstanding the fact that the taxpayer acting for another has no right, title or interest in the money or property received, he is not entitled to deduct such income from his gross receipts unless he was acting as a true agent subject at all times to the control of his principal.*

Id (emphases added).

The protestant's agency argument by its own terms is governed by subsection (1). Its assertion that it immediately turned over the alleged commissions to the Ohio and Kentucky Subchapter S corporations implies that the insurer had no right, title or interest in those sums, and thus is governed by subsection (2), of the former regulation. IC § 6-8.1-5-1(b), discussed under Issue I, imposes the burden of proving each of these elements on the protestant. The statute essentially requires "the person against whom the assessment is made," *id.*, to raise, prove and convince the Department of any affirmative defenses to the assessment that the person may have. Agency and the absence of any right, title or interest in the assessed receipts are such defenses. *See W. Adj. And Insp. Co. v. Gross Income Tax Div.,* 142 N.E.2d 630, 635 (Ind. 1957) (stating that the taxpayer "ha[s] the burden of making out an affirmative [agency or trusteeship] case"). *Cf. Vawter v. Baker,* 23 Ind. 63, 65 (1864) (holding agency to be an affirmative defense in a breach of contract action and placing the burden of proof of agency on the defendant). However, the last passage emphasized in the above-quoted regulation makes it clear that an agency relationship must be found to exist before the question of an assessed person's absence of any right, title or interest in receipts becomes material. Accordingly, before the Department can address the protestant's assertion that the insurer immediately turned the alleged commissions over to the Ohio and Kentucky Subchapter S corporations, the Department must first find that there were agency relationships between each of these corporations as principals and the insurer as agent. The Department therefore turns to this latter question first.

The definition of "agency" in subsection (1) of the former regulation is in substantial accord with Indiana judicial definitions of "agent." "An agent is one who acts on behalf of some person, with that person's consent and subject to that person's control. *See Dept. of Treasury v. Ice Service, Inc.,* 220 Ind. 64, [67-68,] 41 N.E.2d 201[,] [203] (Ind.1942) (citing RESTATEMENT (SECOND) OF AGENCY § 1(1) (1958) [sic])." *Oil Supply Co. v. Hires Parts Serv., Inc.,* 726 N.E.2d 246, 248 (Ind. 2000). Therefore, "the elements of an actual agency relationship are three: [1] manifestation of consent by the principal; [2] acquiescence by the agent; and [3] control exerted by the principal." *Hope Lutheran Church v. Chellew,* 460 N.E.2d 1244, 1247 (Ind. Ct. App. 1984). The principal's right to and exercise of control need not be complete. *Universal Group Ltd. v. Ind. Dep't of State Revenue,* 642 N.E.2d 553, 557-58 (Ind. Tax Ct. 1994) ("*Universal Group III*"), *granting reh'g on and withdrawing* 634 N.E.2d 891 (Ind. Tax Ct. 1994). However, as former 45 IAC § 1-1-54(1) stated, "[t]his right to control cannot be limited to the accomplishment of a desired result[,]" *id.*, which is the criterion for identifying an independent contractor. "*An*

agent, on the other hand, is subject to the control of the principal with respect to the details of the work." *W. Adj.,* 142 N.E.2d at 634 (emphasis added).

B. THE PROTESTANT HAS SUBMITTED NO EVIDENCE THAT THE TAXPAYER'S CREDIT INSURANCE SUBSIDIARY WAS AN AGENT OF EITHER THE OHIO OR THE KENTUCKY SUBCHAPTER S CORPORATION AS TO THE ALLEGED COMMISSIONS.

The only material that the protestant has offered to the Department is its uncorroborated assertion that the insurer was acting as the Ohio and Kentucky Subchapter S corporations' agent. Such a statement is not proof of agency under Indiana common law. "It is a well established rule that agency cannot be proven by the declarations of the agent alone." *United Artists Theatre Circ., Inc. v. Ind. Dep't of State Revenue,* 459 N.E.2d 754, 758 (Ind. Ct. App. 1984). Former 45 IAC § 1-1-54(1) adopted this rule in substance. "[T]he representation of one party that he is an agent of another without a manifestation of consent by the alleged principal is insufficient to establish agency." *Id.* The Department cannot presume that the insurer was the agent of the Ohio and Kentucky Subchapter S corporations based solely on the protestant's unsubstantiated assertion. If anything, the idea of the insurer acting as an agent for those two companies, which would themselves be called "agencies" if they were in fact selling insurance, while not impossible, appears at first blush to be an implausible case of the tail wagging the dog. The Department therefore cannot simply accept the protestant's assertion without actual proof that the insurer was an agent. "An administrative tribunal cannot rely on its own information for support of its findings, and an order of the tribunal must be based on *evidence produced in the hearing*…." *Derloshon v. City of Ft. Wayne Dep't of Redev.,* 234 N.E.2d 269, 273 (Ind. 1968) (internal quotation marks omitted; emphasis added). The protestant has submitted no evidence during this protest that the insurer acted as the agent of either Subchapter S corporation, or what kind of work it did for them under any alleged agency agreements, including why it was holding the alleged commissions for these companies. Nor has the protestant submitted any evidence that they exercised control over the insurer, or how much or what kind of control they exercised. Given the lack of any evidence of agency, the Department therefore must presume that the insurer was not the agent of either the Ohio or the Kentucky Subchapter S corporation.

C. EVEN IF THE CREDIT INSURANCE SUBSIDIARY HAD BEEN AN AGENT, AS A MATTER OF LAW IT HAD AN INTEREST IN THE ALLEGED COMMISSIONS.

Since the protestant has not provided any evidence of agency to the Department, it is unnecessary, strictly speaking, for the Department to address the protestant's implied lack-of-right-title-or-interest argument. However, the Department would note that even if the protestant had submitted evidence sufficient to establish that the insurer was an agent, the protestant's assertion that the insurer lacked any interest in the alleged commissions is insufficient in law. Former IC § 6-2.1-1-2(b) stated that "no deductions from a taxpayer's gross income may be taken for [among other items]…commissions paid or credited[.]" *Id.* The implementing regulation, former 45 IAC § 1-1-17 (last version at 45 IAC § 1.1-1-10), is to the same effect. Former 45 IAC § 1-1-64, which applied the definition of the phrase "gross income" in former IC § 6-2.1-1-2(a) to life, health and hospitalization insurance companies, is also relevant to this question. It read in relevant part as follows:

> The gross income tax applies to those life, health and hospitalization insurance companies that do not elect to pay the [gross] premium tax as administered by the Indiana Department of Insurance under IC 27-1-18-2(b) of the Indiana Insurance Act.
>
> Gross income as it applies to receipts of life, health and hospitalization insurance companies means the amount of gross premiums, interest, dividends, rents and all other earnings with respect to conducting the business of the company. *Commissions, fees or other expenses incurred with respect to the various insurance company transactions are not to be deducted in determining gross earnings therefrom;....*

Id (emphasis added). (Similarly, the gross premiums tax of IC § 27-1-18-2 does not permit commissions to be deducted. *Id.*)

Former IC § 6-2.1-1-13 defined "taxable gross income as "the remainder of: all *gross income* which is not exempt from tax under IC 6-2.1-3; *less* (2) *all deductions* which are allowed under IC 6-2.1-4." *Id* (emphases added). "Deduction" is in turn defined in relevant part as "[a]n amount subtracted *from gross income*…." BLACK'S LAW DICTIONARY 422 (definition 2) (7th ed. 1999) (emphasis added). Both authorities thus necessarily imply that a sum that a taxpayer seeks to deduct was already part of that taxpayer's gross income. This latter circumstance in turn necessarily implies that the taxpayer in question (and not some other entity) had a right, title or interest in that gross income. By stating that commissions are not deductible, the legislature decided that commissions were to remain part of the gross income that is the proceeds of a sale of a principal's property or product that the agent or broker helped the parties consummate. In the present case, the product was credit life insurance policies and the proceeds were premiums, all of which (including the alleged commissions) were, and remain, gross income to the insurer. The insurer in turn was a member of the taxpayer's affiliated group. The taxpayer therefore was, and the protestant as its successor in interest is, liable for gross income tax on its receipts for these premiums/alleged commissions.

Neither the agency tax opinions discussed above, nor former 45 IAC § 1-1-54, require a different result. For the Department to find that this part of the assessment was wrong, it would also have to interpret these authorities as allowing a deduction from gross income that both the General Assembly and this Department have explicitly stated is not available. Only the legislature can create deductions. *Cf. Rotation Prods. Corp. v. Dep't of State Revenue*, 690 N.E.2d 795, 798 (Ind. Tax Ct. 1998)(stating that "courts have no power to create an exemption in the absence of statutory authority"). The Department cannot create a deduction. "It does not lie with the Department to promulgate a regulation in excess of, or contrary to, the law." *Universal Group III,* 642 N.E.2d at 557. It would be particularly inappropriate for the Department to do so as to this issue because it would create a conflict between former 45 IAC § 1-1-54, the regulation making income received in an agency capacity not subject to gross income tax, and former 45 IAC § 1-1-64, which stated that commissions are not deductible from the gross income of life, health and hospitalization insurance carriers. As previously noted under Issue I, the rules governing statutory interpretation also govern

interpretation of regulations. *Two Market Square Assocs.*, 679 N.E.2d at 885. The Department promulgated former 45 IAC §§ 1-1-54 and -64 at the same time. *See* Final Rules, Gross Income Tax, LSA Doc. No. 8-15(F), 1 I.R. 950, 962 and 966 (1978), respectively. Statutes relating to taxation and enacted simultaneously "must be construed together as parts of one body of law and as together expressing the legislative will." *Lutz v. Arnold*, 193 N.E. 840, 848 (Ind. 1935). It therefore follows that regulations relating to taxation and promulgated simultaneously by the same agency must also be construed together. *See id.* Accordingly, the Department construes former 45 § 1-1-54 as not having created a deduction for commissions.

The protestant, therefore, has failed to sustain its burden of proof that the part of the gross income tax assessment for fiscal year 1993 on the management fees or alleged commissions was wrong. These sums were part of the taxpayer's gross receipts or gross income under former IC §§ 6-2.1-1-2, -1-10 and -1-11, former 45 IAC §§ 1-1-8 to –10, -17, -51 and -64. The field auditor was therefore correct to assess the taxpayer for those receipts because under former IC § 6-2.1-2-2(a)(1) they were part of the entire taxable gross income of a taxpayer who was a domiciliary of Indiana.

FINDING

The protest is denied as to this issue.

VI. Gross Income Tax—Imposition on Domiciliary—Source State of Gross Income—Other Miscellaneous Gross Receipts From Out-of-State Business Situses

DISCUSSION

The auditor also proposed to assess gross income tax on certain receipts characterized on the taxpayer's chart of accounts as "Miscellaneous Income: Other." As it did with the pre-need contract interest and the pre-need trust interest and dividends, the protestant argues that these unidentified receipts are not subject to Indiana gross income tax because non-Indiana business locations generated them. However, the protestant has not submitted any evidence on this issue, and has not even specified the activity or activities that generated these receipts. The Department accordingly finds, as it did under Issues I, II, IV and V, that the protestant has also failed to sustain its burden of proof that the assessment of gross income tax for each year of the audit period on the other miscellaneous receipts was wrong.

FINDING

The protest is denied as to this issue.

VII. Gross Income Tax—Imposition on Domiciliary—Source State of Gross Income—Miscellaneous Service Gross Receipts (Open/Close Trust Withdrawals) (Fiscal Year Ending 09/30/1993)

DISCUSSION

Each member of the taxpayer's Indiana affiliated group engaged in cemetery operations provided what the taxpayer called "opening/closing services," consisting of the digging of a grave before, and the filling of that grave after, any graveside service for a decedent. After completing the closing, the member that performed these services received a withdrawal from the local pre-need trust. The taxpayer described these receipts as "Open/Close Trust Withdraw" (sic) on its chart of accounts and reported them as "Other Income" on Line 10 of its federal Forms 1120 for each year of the audit period. The auditor allocated the full amounts of the withdrawals reported on the federal returns to the taxpayer's Indiana commercial domicile and proposed to assess gross income tax on them at high rate pursuant to former 45 IAC § 1-1-112, previously discussed under Issue III.

The protestant challenges the parts of the assessments levied on the open/close trust withdrawals on the grounds that the locations that allegedly received those payments, and the trusts from which they received them, were all outside Indiana. The Department has already found under Issue II above that the domiciles of the various pre-need trustees are irrelevant and, without more, are no bar to imposing Indiana gross income tax on pre-need trust distributions. That discussion is incorporated by reference as if fully set out here. The protestant has not submitted any books, records or other documents to the Department to support its other assertion. There is thus no evidence before the Department indicating the respective amounts of open/close trust withdrawal receipts that were attributable to openings and closings conducted at the taxpayer's out-of-state and in-state cemeteries.

In *Indiana Department of State Revenue v. E.W. Bohren, Inc.*, 178 N.E.2d 438 (Ind. 1961), the Indiana Supreme Court cited the failure of the taxpayer in that case to segregate intrastate from interstate receipts as one basis for its denying that taxpayer the interstate commerce exemption of U.S. CONST. article I, § 8, clause 3 and a predecessor to former IC § 6-2.1-3-3. 178 N.E.2d at 442. As statutory support for this part of its rationale, the court cited to a predecessor to former IC § 6-2.1-2-7. Subsection (b) of the latter statute required gross income taxpayers to separate on their records gross income that was taxable at different rates (the lower rate presumably being zero where part of the receipts were eligible for an exemption). *Id.* Subsection (c) subjected the entire gross income to the higher applicable rate if the taxpayer failed to properly segregate the income that would otherwise be taxable at the lower rate. *Id.*

The Department finds both *E.W. Bohren* and former IC § 6-2.1-2-7(b) and (c) to be persuasive analogous authority on the present issue. The question of whether receipts were earned in interstate commerce can be closely related, although not necessarily identical, to the question of whether an out-of-state business or legal situs earned those receipts. If failure to segregate receipts can be a basis for denying the interstate commerce exemption, then it can also be a proper basis for denying an exclusion from gross income of receipts from a taxpayer's out-of-state business or legal situses. The protestant has failed to submit any evidence that the taxpayer

made such a segregation of receipts. For this reason, and because of the previously mentioned irrelevance of the pre-need trusts' situses, the protestant has failed to meet its burden of proof on this issue.

FINDING

The protest is denied as to this issue.

VIII. Gross Income Tax—Deductions from Gross Income—Inter-Company Transactions

DISCUSSION

A. THE "INTERCOMPANY CHARGES" AND "OVERHEAD ALLOCATIONS" ADJUSTMENTS

The taxpayer reported certain receipts it described as "Intercompany Charges" under "Other Income" on each of its federal Forms 1120 for the audit period. It also reported its "Overhead Allocations" under "Other Deductions" at Line 28 on its Forms 1120 for fiscal years 1994 and 1995. The auditor disallowed in full or in part the inter-company transaction deductions from gross income that the taxpayer had claimed for these receipts under former IC § 6-2.1-4-6(a) on its Forms IT-20 for the audit period. The work papers indicate that the auditor based the disallowance in part because he could not identify the affiliates that had paid on the various "Intercompany Charges" and "Overhead Allocations" and could not establish whether the taxpayer had included these subsidiaries in the Indiana affiliated group. The auditor disallowed the deduction in full for fiscal year 1993, and partly disallowed the deductions for fiscal years 1994 and 1995. He did allow the deductions for these latter years as to certain receipts described in the Audit Summary as "Intercompany Eliminations." (The implementing regulation, former 45 IAC § 1-1-166, stated in pertinent part that "receipts from *intercompany* sales of property and payments of dividends, rents, interest and service charges may be *eliminated* from gross receipts." *Id* (emphases added)). However, the auditor also disallowed the deductions for fiscal 1994 and 1995 as to both "Intercompany Charges" and "Overhead Allocations," less the respective amounts for these years of the "Intercompany Eliminations," each of which was smaller than the respective sums of the other two categories. Thus, the net effect of the adjustments for these years was to disallow the deductions in part.

B. THE PROTESTANT'S ARGUMENT

The protestant objects to these adjustments on the ground that the auditor allegedly failed to recognize that certain subsidiaries were qualified to do business in Indiana. It indicated in its protest letter that the taxpayer was entitled to deduct "Intercompany Charges" in all three years of the audit period attributable to six such subsidiaries, which the Department will call Subsidiaries 1 through 6. The protestant also indicated in its protest letter that the taxpayer was entitled to deduct "Overhead Allocations" in fiscal years 1994 and 1995 of three such companies. Subsidiary 1 was among these latter subsidiaries. The Department will identify the other two as Subsidiaries 7 and 8.

C. MOST, BUT NOT ALL, OF THE SUBSIDIARIES IN ISSUE WERE AUTHORIZED TO DO BUSINESS IN INDIANA FOR MOST OF THE AUDIT PERIOD.

The protestant is correct to recognize that authorization to do business in Indiana is one of the conditions of entitlement to claim the inter-company transactions deduction. Former IC § 6-2.1-4-6(a), which granted this deduction, stated that

> [e]xcept as provided in subsections (b) and (c), [which are not in issue here,] each taxable year an affiliated group or corporations filing a consolidated return pursuant to IC 6-2.1-5-5 is entitled to a deduction from the gross income reported on such a return. The amount of the deduction equals the total amount of gross income received during the taxable year from transactions *between members of the group* that are incorporated or *authorized to do business in Indiana*.

Id (emphases added). (Incorporation, or authorization to do business, in Indiana was also a condition of eligibility to file a consolidated gross income tax return by virtue of former IC § 6-2.1-5-5(b). *Id.*)

However, the protestant has not submitted any evidence to substantiate its assertion that Subsidiaries 1 through 8 were authorized to do business in Indiana. The Department therefore has searched the on-line records of the Business Services Division of the office of the Indiana Secretary of State under the names of each of these subsidiaries to learn whether they were authorized to do business in Indiana during the audit period, and if so for which year/s. The results of that search are summarized in the following table:

Subsidiary No.	Fiscal Year 1993	Fiscal Year 1994	Fiscal Year 1995
1	Not authorized	Authorized (03/31/1994)	Authorized (but withdrew 12/28/1995)
2	Not authorized	Not authorized	Not authorized
3	Not authorized	Authorized (04/14/1994)	Authorized (but withdrew 12/28/1995)
4	Not authorized	Authorized (04/06/1994)	Authorized (but merged 05/30/1995)
5	Not authorized	Authorized (4/14/1994)	Authorized (but withdrew 12/28/95)
6	Not authorized	Authorized (04/14/1994)	Authorized (but merged 12/31/1995)
7	Not applicable	Authorized (04/07/1994)	Authorized (but merged 12/31/1995)
8	Not applicable	Not authorized	Not authorized

It is thus clear from the above table that the auditor was correct to deny the inter-company transactions deduction for fiscal year 1993 in its entirety, for Subsidiary 2 for the entire audit period and for Subsidiary 8 for fiscal years 1994 and 1995. It is also clear that Subsidiaries 1 and 3 through 7 were authorized to do business in Indiana in the latter two fiscal years.

D. HOWEVER, THE PROTESTANT HAS SUBMITTED NO EVIDENCE THAT BOTH PARTIES TO THE "INTERCOMPANY CHARGES" AND "OVERHEAD ALLOCATIONS" TRANSACTIONS WERE AUTHORIZED TO DO BUSINESS IN INDIANA

What is not clear, however, is whether each of the "Intercompany Charges" and "Overhead Allocations" arose "from transactions *between members of the group that* [were] incorporated or *authorized to do business in Indiana*." IC § 6-2.1-4-6(a) (1988) (1993) (repealed 2003) (emphases added). The taxpayer did not produce any records during the audit, and the protestant did not submit any records to the hearings officer, indicating that both parties to each transaction in these two categories were incorporated or authorized to do business in this state. The parent, which was party to the "Overhead Allocations," admittedly was an Indiana corporation, but in the absence of records the Department cannot simply assume that all of the transactions that generated the receipts in this category were between the parent and Subsidiaries 1, 7 or 8. Similarly, the Department cannot assume that all of the "Intercompany Charges" were paid to Subsidiaries 1 through 6 by, or that one of these subsidiaries received such charges from, a company that was incorporated or authorized to do business in Indiana. The unidentified parties to these transactions may have been members of the taxpayer's federal affiliated group, but not of its Indiana affiliated group. The auditor therefore was correct to deny the inter-company deductions for fiscal years 1994 and 1995 as well.

FINDING

The protest is denied as to this issue.

IX. Tax Administration—Amending Returns—Departmental Authority to Amend

Gross Income Tax—Imposition on Domiciliary—Source State of Gross Income—(Insurance Commissions)(Fiscal Year Ending 09/30/1994)

Gross Income Tax—Deductions from Gross Income—Bad Debt Deductions (All Years)

DISCUSSION

The protestant has asked the Department to amend the taxpayer's return for fiscal year 1994 to remove certain insurance commission gross income from the taxpayer's Ohio and Kentucky subsidiaries that the protestant alleges that the taxpayer erroneously included in that return. The protestant also asks that the Department amend the taxpayer's returns for all three years of the audit period to include deductions for certain alleged bad debts that the taxpayer failed to claim. The two adjustments combined, if granted, would not generate any refunds.

Strictly speaking, neither of these requests is a protest issue, since the protestant is not requesting these adjustments in response to anything that the auditor did or failed to do. Nevertheless, in the interest of efficiency and completeness, and because the requested insurance commissions adjustment relates to Issue IV of this protest on the same subject, the Department will address the protestant's requests in this letter.

The protestant cannot claim that it is, or the taxpayer was, ignorant of the Indiana income tax laws and their reporting deadlines. "All persons are charged with the knowledge of the rights and remedies prescribed by statute." *Middleton Motors, Inc. v. Ind. Dep't of State Revenue,* 380 N.E.2d 79, 81 (Ind. 1978). Nor can the protestant seriously claim that it or its two predecessors were unable, or in need of the Department's help, to comply with those deadlines. The taxpayer and its first successor in interest operated, and the protestant operates, a complex multi-jurisdictional business requiring sophisticated management. Therefore, the taxpayer and both its successors were perfectly capable of timely and appropriately amending the taxpayer's Indiana income tax returns. In this connection the Department notes that in the summer of 1996 the taxpayer's first successor in interest filed Forms IT-20X (Amended Corporation Income Tax Return) for the taxpayer for fiscal years 1992, 1993 and 1994 to conform the original returns to the adjustments the IRS made in its audit of the taxpayer for those years. It would have been a simple matter for the first successor in interest to draft the amended returns for fiscal years 1993 and 1994, and to draft an amended return for fiscal year 1995, to include the changes the protestant now requests. The fact that it did not do so may not be the protestant's fault, but that circumstance does not enable the protestant to take the place of the General Assembly and to convey power on the Department that the legislature did not grant.

Lastly, even if the Department were authorized to make the amendment requested for 1994 in particular and the protestant had requested it timely, the Department would not grant it. In the absence of contrary evidence, the insurance commission gross income in question was earned in Indiana for the reasons given under Issue IV. The Department fully incorporates the Discussion of that issue by reference here.

FINDING

The protestant's requests for the Department to amend the taxpayer's Indiana income tax return for fiscal year 1995, and to further amend its Indiana income tax returns for fiscal years 1993 and 1994, are denied.

X. Tax Administration—Negligence Penalty (Inter-Company Service Charges Adjustment)

DISCUSSION

The auditor recommended, and on review the Audit Division approved, proposing the assessment of ten percent negligence penalties on the parts of the proposed assessments levied on inter-company service charges. The protestant requests that the Department waive these

penalties. It makes general allegations that the taxpayer did not act negligently and made good faith efforts to comply with the Indiana tax laws, and that the Department has made no showing that the taxpayer engaged in willful neglect or bad faith.

As mentioned under Issue I above, under IC § 6-8.1-5-1(b) (1998) the person against whom a proposed assessment is made has the burden of proof that it is wrong. As to penalties in particular, "[a] person who wishes to avoid the penalty imposed under [IC § 6-8.1-10-2.1(a) and (b) (1998)] must make an affirmative showing of all facts alleged as a reasonable cause for the person's failure to file the return, pay the amount of tax shown on the person's return, pay the deficiency, or timely remit tax held in trust[.]" IC § 6-8.1-10-2.1(e). *See also* 45 IAC § 15-11-2(c) (2001) requiring a taxpayer to "affirmatively establish[,]" specifying the standard for the existence of, and enumerating the factors that may be considered in determining the presence or absence of, reasonable cause). The burden of proof is not on the Department to show willful neglect or bad faith. The protestant has made no factual showing of reasonable cause why the Department should waive the proposed negligence penalties, and has accordingly failed to meet its burdens of production and proof on this issue.

FINDING

The protest is denied as to this issue.

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